BEFORE THE COMMISSIONER OF SECURITIES AND INSURANCE
MONTANA STATE AUDITOR

IN THE MATTER OF THE CONVERSION
OF BLUE CROSS AND BLUE SHIELD OF MONTANA, INC. AND ALLIANCE WITH HEALTH CARE SERVICE CORPORATION,

Case No. INS-2012-238

Applicants.

TRANSCRIPT OF PROCEEDINGS

Taken At:
MONTANA SUPREME COURT
215 NORTH SANDERS
HELENA, MONTANA
MARCH 13, 2013

W. WILLIAM LEAPHART, PRESIDING

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APPLICANTS' WITNESSES

COMMISSIONER OF SECURITIES AND INSURANCE WITNESS

(Whereupon the following proceedings were had on March 13, 2013.)

HEARING EXAMINER LEAPHART: First of all, I would like to remind any members of the public that haven't done so, please sign in on the sign-up sheet.

And with that, we can resume with the Applicant's case. I believe we left off with HCSC.

MR. KALECZYZ: Mr. Black is here, and Kelley was not here a moment ago.

HEARING EXAMINER LEAPHART: Okay.

MR. KALECZYZ: Maybe it's okay to proceed.

MR. BLACK: Kelley should be here any second.

HEARING EXAMINER LEAPHART: Here she comes.

MS. HUBBARD: My apologies.

HEARING EXAMINER LEAPHART: Present your next witness.

MS. LENMARK: The Applicants call Dr. Thomas McCarthy.

HEARING EXAMINER LEAPHART: Good morning.

THOMAS R. MCCARTHY, Ph.D.,

a witness, after having been first duly sworn, testified upon his oath as follows:

DIRECT EXAMINATION

BY MS. LENMARK:

Q. Dr. McCarthy, would you introduce yourself for the

Court.
A. My name is Tom McCarthy. I'm the Senior Vice President with a company called Nera Economic Consulting and I head up Nera's healthcare practice.
Q. Dr. McCarthy, I am going to hand to you what has been identified as your Direct Testimony.
A. Yes.
Q. Do you affirm your testimony?
A. Yes.
MS. LENMARK: Pass the witness.
HEARING EXAMINER LEAPHART: Cross-examination from the Commissioner.

CROSS-EXAMINATION

BY MR. ANGOFF:
Q. Good morning, Dr. McCarthy.
A. Good morning.
Q. You've done two reports in this case, correct?
A. That's right.
Q. And what are those reports?
A. One was the Community Impact Report and the other one is in a sense the subset of the Community Impact Report, which is an Antitrust Report.
Q. And I'll be asking you a few questions about those reports. Do you have those in front of you?
A. I do not.

Q. Would you like to refer to them?
A. We can try it and see how far we get. I may need to refer to them.
MR. ANGOFF: May I approach the witness, your Honor?
HEARING EXAMINER LEAPHART: Yes.
Q. (By Mr. Angoff) So Dr. McCarthy, one of your reports was an Antitrust Report, right?
A. Correct.
Q. And the share of the market in Montana--
HEARING EXAMINER LEAPHART: Counsel, are these reports in the application binder?
MR. ANGOFF: Yes, your Honor, they both are. One is a Community Impact Report and one is a Competitive Impact Report.
THE WITNESS: It says Antitrust Report is the way it's labeled.
HEARING EXAMINER LEAPHART: Do you know which tabs they're under?
MS. LENMARK: Your Honor, the Antitrust Report is Exhibit 6 to the application.
HEARING EXAMINER LEAPHART: Exhibit?
MS. LENMARK: Exhibit 6.
HEARING EXAMINER LEAPHART: 6.
MS. LENMARK: And the Community Impact Report

is Exhibit 4 to the application.

HEARING EXAMINER LEAPHART: Thank you. Proceed.

Q. (By Mr. Angoff) So Dr. McCarthy, HCSC really isn't in the Montana market at all, are they?

A. Not as a competitor, not as an active competitor. They have lives here.

Q. And how do they come to have lives here?

A. Mainly through national accounts.

Q. But you don't see them as competing with Blue Cross of Montana, correct?

A. I do not.

Q. But nevertheless, you did what's called a Form E analysis. What is that analysis?

A. A Form E analysis is something that I think is generally developed by NAIC. It looks at shares along different lines of business and it talks about triggers that may trigger what's called evidence from the prima facie case that there's a competitive problem, and then it provides for various approaches to the extent that you trigger the prima facie case.

Q. And even under that Form E analysis, which really isn't necessary, right, because HCSC has essentially no share of the Montana market, right?

A. That's absolutely right.

Q. But even under that analysis, HCSC still has less than one percent of the entire Montana health insurance market, right?
A. Yes, under the lines of business looked at in that report, that's right.
Q. And it's got less than one percent of -- there's no line of business under which it's got even as much as one percent, right?
A. Correct, average over the last five years, correct.
Q. So those are tiny, tiny percentages, obviously?
A. Yes, they are.
Q. Could a firm, though, have so much of a market share, of such a high market share that even a tiny, tiny percentage increase could have an anti-competitive impact?
A. Not -- there's no sort of convention or theory or practice in antitrust where that's the case. And another way you can look at that is the way Dr. Tardiff looked at it, which is to say how much did it increase what's called the HHI, how much did it increase concentration, and the answer is it didn't increase concentration by a material amount either. That's just a different way of looking at the same thing.
Q. Sure. So then, even if an insurance company has,

as your data show, Blue Cross does 90 percent share or 91 percent share over five years in the individual market, a tiny, tiny percentage would not -- increase in that share would not cause a competitive impact?

A. I think not. And there's already -- the way you and I are talking now, it's sort of just a measure of the market structure. In other words, it doesn't really get to how competition is actually occurring. And as you probably know, Blue Cross of Montana is suffering underwriting losses, so to the extent that their shares are sufficient to warrant raising price, a 91 percent share shouldn't already allow that. Of course, you're only talking about one line of business when you talk about the individual.

Q. I'm sorry, you're saying a 91 percent share should allow what?

A. If anybody can raise price, if you're worried about the share and some small increment to that share, we can see from a competitive point of view, that Blue Cross of Montana has not been able to raise prices. They're suffering from underwriting losses.

Q. Even with Blue Cross with the 90 or 91 percent share has not been able to raise prices?

A. Well, it has not been able to -- it has not been able to raise prices to the point where they've got an

underwriting gain.
Q. Now, you did another report, your Community Impact Report, right?
A. Yes.
Q. Okay. And one of the conclusions in that report was that HCSC can get better prices from its vendors than Blue Cross of Montana since it can drive bigger quantities, right?
A. Yes.
Q. That just stands to reason, like -- that's like Wal-Mart, isn't it, you have a lot of business. You have a lot of customers. You can get volume discounts. Isn't that right?
A. For some vendors under some circumstances, yes.
Q. And so when you wrote that, what vendors did you have in mind?
A. Well, I think it's -- we can go back and visit that paragraph, but I think it's implied in the paragraph. It's on the administrative cost side, it's on the software licensing, it's not -- you use computer paper, I'm sure they get a pretty good price on office supplies as well. So I think it's generally characterized in the report.
Q. But you don't believe that the extra bargaining power that HCSC brings to this transaction, if it's

approved, would result in lower prices to providers?
A. I do not because there is no extra bargaining power.
Q. Okay. And why is that?
A. Because right now, when provider contracting people from Montana Blue Cross go out and negotiate, the provider understands that there's a volume that he or she is likely to get, and that volume includes BlueCard members, which means the members of Blue Cross/Blue Shield who are outside the state of Montana like the HCSC people.

So it's already understood that in negotiating the reimbursements that go into a provider contract, you've already got the volume of what I'll call the local volume, the state volume, the Blue Cross/Blue Shield of Montana and all of the BlueCard members, including HCSC.
Q. So the transaction, if it's approved, should not result, in your opinion, in any change in -- in lower prices to providers?
A. That's correct, it should not.
Q. Is it a good thing or a bad thing for consumers if it does result in lower prices to providers?
A. It very well could be a good thing for consumers. The sort of willing buyer, willing seller in contracting is something that has to be marked out in the market,

and but to the extent expenses, any kind of expense can be reduced, then that means premiums can be reduced.

Q. So if providers were paid less, premiums could be reduced?

A. It's possible, yes.

Q. But here you say that through interviews, you learned that Montana providers are aware of both Blue Cross's volume and the BlueCard volume when negotiating managed care contracts with Blue Cross, right?

A. That's correct.

Q. And which providers did you interview to find that out?

A. We talked to the provider relations people at Blue Cross. We didn't interview providers.

Q. And are you familiar with Mr. Galasso's study in this matter?

A. I know of it but I've not read it.

Q. Would you be surprised to learn that he assumed that HCSC would not only not pay providers less, but would pay providers more because HCSC would not get the benefit for discounts Blue Cross -- of all the discounts that Blue Cross has negotiated with providers? Do you agree with that?

A. I'm not sure I even understand it. I haven't read it but if you don't mind, try to explain that again.

That the prices would be higher?
Q. Sure. Blue Cross has contracts -- do you know that Blue Cross has contracts with providers today--
A. Sure.
Q. --that provide for certain discounts?
A. Sure.
Q. And so Mr. Galasso assumed that if the transaction is approved, those provider contracts will not automatically be transferable and he didn't feel comfortable assuming that HCSC would simply be able to retain all of those discounts, instead assumed that HCSC would retain part of them but not all of them resulting in higher prices paid by HCSC. And I'm just asking whether you think that makes sense?
A. My prediction would be that they would get the discounts. They would get the same or extremely similar discounts to the extent that the contract is being renegotiated. It may have been renegotiated six months from now anyway. But in general, they would achieve the same discounts.
Q. You wouldn't think they would get greater discounts?
A. There's no basis for greater discounts at this point. If they're successful in growing and they create greater volume, they might be able to achieve discounts

in the future.
Q. And did you look at the prices that HCSC pays to providers in the other states in which it now operates Blue Cross plans?
A. No.
Q. And did you look at the prices that HC -- that the Blue Cross plans in those states that HCSC now operates paid before to providers before HCSC took them over?
A. I did not do that study, no.
Q. Now, would Blue Cross's -- would HCSC's greater scale, do you believe, have any effect on compensation to insurance agents?
A. No. There's no greater scale in Montana in dealing with Montana brokers and agents. In other words, that's not a scalable -- whatever piece exists in Montana in the alliance with Blue Cross/Blue Shield of Montana is the same amount that would be here after the transaction.
Q. Okay. And are you familiar with Dr. Galasso's assumption regarding agent compensation?
A. I have not reviewed his study, so no, I'm not.
Q. Would it surprise you to learn that Dr. Galasso in his study assumed that agents would be paid a point less in commission going forward? Would that surprise you?
A. It wouldn't necessarily surprise me because it

depends on what you're comparing it to. The future growth is going to be, as I think you well know, based on exchanges or a lot of the business will be based on exchanges, and the role of brokers in the face of that change may cause a change in their commissions, but it's not tied, at least in my mind -- I don't know Dr. Galasso's mind on this, but at least in my mind, it's tied to the ACA being implemented more than to any change in bargaining strength of Montana Blue.

Q. Then is it fair to say that you believe that agent compensation may well be reduced in the future but it won't be as a result of this transaction?

A. It's fair to say that, yes.

Q. Now, you also conclude in your Community Impact statement, that HCSC has much lower administrative expenses than Blue Cross of Montana, right?

A. Correct.

Q. Okay. And you conclude that because of that, Blue -- if the transaction goes through, premiums are likely to go down, right?

A. Premiums could go down, yes.

Q. What evidence, if any, did you look at that convinces you that the administrative expense cost savings that would arise from the transaction would be passed through to consumers in the form of lower prices?

A. Well, let me be clear. It's like the discussion in the national budget. What we're talking about is lower rates of increasing premiums is much more likely. I mean, it's possible some lines of business there could be a temporary decrease, but we're talking about changes in the rate of increase in the premiums.

And the reason I believe that that's likely is because of the competition in the state of Montana. In order to win business, you want to take those efficiencies and turn them into both a healthier margin, an underwriting gain instead of an underwriting loss, and in lower premiums.

Q. Do you grip the possibility, though, that at least some of that administrative expense advantage that the merged company would have would be retained by HCSC and not passed through?

A. It may. I wouldn't think of it that way. Someone said -- I don't remember. Yesterday, someone said, look, they've got to pay attention to their core business, and in your core business, you should have an underwriting gain. And I believe that's right.

And so to the extent that they're -- that the efficiencies will also help to stabilize the financial condition of Blue Cross of Montana, that's a good thing. I think that the efficiency gains based on what's

happened in their previous integrations and based on the differences that we already see are sufficient that premiums will be -- the growth rate of premiums will be restricted as well from the efficiencies. So I do think both things will be accomplished, lower premium, growth and more stable financing.

Q. Did you look at the current premiums charged by Blue Cross in the Montana market?

A. Not specifically.

Q. Okay. And did you look at the current premiums charged by any other company in the Montana market?

A. We looked at the competition in the market and that has an implication for premiums because price is obviously a very important element of why an employer or an individual chooses an insurer.

Q. But you didn't look at the premiums themselves?

A. No. No, the premiums are all over the place.

Q. Okay. And what about in Oklahoma, did you look at the premiums, the actual premiums charged by insurers now, but by HCSC today in Oklahoma?

A. No, I didn't. Dr. Tardiff has done a study like that. I'm sure you're familiar with that. He found that when -- both in Oklahoma and in Texas and well and in New Mexico, that premiums generally fell after the acquisition was made by HCSC.

Q. But you didn't look at the premiums that were charged by HCSC in Oklahoma?
A. No.
Q. Okay. And did you look at the premiums that were charged by Blue Cross of Oklahoma before they were acquired by HCSC?
A. No.
Q. Okay. And did you look at the premiums charged in New Mexico by HCSC?
A. No.
Q. And did you look at the premiums charged by Blue Cross of New Mexico before they were acquired by HCSC?
A. I did not.
Q. Did you ask HCSC whether they include a certain level of underwriting profit in their rate filings?
A. No, I didn't ask them about their rate filings.
Q. And do you have any opinion as to what a reasonable level of underwriting profit for a nonprofit insurance company would be?
A. No, I don't. There's a whole -- there's a whole package of things that are going on year to year to year, and what's healthy one year may not be the healthy level in another year. I don't know if that's a definitive number.
Q. Are you familiar with the medical loss ratio

concept?
A. Yes.
Q. And are you familiar with the Department of Health and Human Services MLR rule?
A. Yes.
Q. And did you ask HCSC whether they targeted a certain medical loss ratio in their rate filings?
A. No, I asked them how they did relative to the medical loss ratios, but I don't remember asking them what their target was.
Q. Do you know whether HCSC met the MLR threshold that's mandated under the HHS MLR ruling?
A. My understanding, although I don't remember the details, my understanding is in the vast majority of their lines of business, yes, but in some, they gave a rebate.
Q. And you didn't ask, did you, what trend factor they used in their rate filings, did you?
A. The trend factor will change their rate filings, so a trend factor is usually based on what the expected medical expense is, and it depends on what the contracts are and it depends on what they've most recently renegotiated, so it changes all the time. It's not an easy question to answer.
Q. Now, you believe, I assume, that the Affordable

Care Act is going to make the health insurance business riskier. Is that fair to say?

A. Yeah, I would say -- I would say right now that it is for sure in the sense that it's a big change that all of the companies have to adjust to. So the uncertainty isn't necessarily that the act itself will make it unpredictable, it's just we've got to make a transition and there's a lot of uncertainty in that transition.

So I think there are two different kinds of uncertainty. One is whether it's more uncertain after everybody is adjusted to it, and the other one is getting there, and I think the getting there is where you find the uncertainty.

Q. And one big difference, isn't it, is that insurance companies in the individual and small group market will have to take everyone beginning in 2014 whereas currently they don't?

A. That's correct, guaranteed issue and guaranteed renewal and no preexisting condition.

Q. And they can only use -- they can only use age as a rating factor to the extent of a three-to-one ratio, right?

A. I don't remember that exactly but I know there's a provision like that.

Q. Okay. Are you familiar with the risk adjustment

mechanism under the Affordable Care Act?
A. I know there is one. I do not know how good it is or how well it will work so that's another uncertainty
Q. But that could substantially mitigate the risk, couldn't it?
A. It could.
It could. It's an important element to try to do risk adjustment.
Q. And are you familiar with the risk corridor program that will stay in effect for three years under the Affordable Care Act?
A. Vaguely, I remember it now that you say it, but I can't tell you what it is.
Q. What about the reinsurance program?
A. Generally, yes.
Q. And those are both mechanisms that conceptually do enable carriers to mitigate their risk to some extent, don't they?
A. But there's a difference between all of those regulatory issues and, you know, whether a given carrier ends up being adversely selected in some line of business. And I understand things like a risk corridor, things like risk adjustment are meant to alleviate some of that, but that still doesn't mean it's going to work that way. And so that's what I'm -- what I think I'm

telling you is there will be a transition. People will adjust. People will adapt.

Regulations may well be revised. And there will be sort of a new equilibrium, but that doesn't mean along the way people aren't going to bear a lot of utilization risk, you know, being adversely selected risk.

Q. But if risk adjustment works, and I think we can agree that it hasn't been implemented yet, right, it doesn't go into effect until 2014?

A. Right.

Q. But the theory of risk adjustment is, isn't it, that any adverse selection will be -- will be counterbalanced because those companies that do get the worse risks will get paid by the companies that got the better risk; isn't that right?

A. I'll accept that on the level of theory, I agree with you. I think if you're going to reform healthcare, an important element of that is risk adjustment and if it works well, then I agree with you, it will end up reducing risk. It's just not clear to me yet if it will work well. I hope it does.

Q. Now, in your Community Impact Report, you refer to an agreement that the administrative services agreement with HCSC, that was only entered into since the two parties expect the proposed alliance to be approved.

That's in footnote 10 on page 4 of your Community Impact statement. Could you tell me what you're referring to there?

A. I would have to look at it. I think we're talking about some of the projects you talked about yesterday. I'm sorry, where were you?

Q. Yeah, I would just like to -- for you to explain what that agreement is all about, if you know. It's footnote 10 on page 4.

A. It must be in the Antitrust Report.

Q. No, it's the Financial and Community Impact Report, November 10, 2012; page 4, footnote 10.

A. This has to do with transition costs.

Q. I'm sorry?

A. This has to do with transition costs, implementation costs, and I think you were asking about the ASA.

Q. Yes.

A. Oh, I see where you are. Sorry about that.

Q. That's okay.

A. Yeah, I think it has to do with the project you were talking about yesterday, that efficiencies -- that both parties could gain efficiencies.

Q. And then at the end, you say, it is our understanding that this agreement was only entered into

since the two parties expect the proposed alliance to be approved. Could you tell me how you came to believe that the two parties expect the proposed alliance to be approved?

A. I mean, it would have been through interviews. I don't remember specifically the context there but it would have been through interviews.

Q. But talking to people at HCSC--

A. Yes.

Q. --and Blue Cross of Montana?

A. Yes.

Q. Now, you also conclude that if the acquisition is approved, Blue Cross of Montana will face strong competition from Cigna, United, PacificSource and EBMS, right?

A. Yes.

Q. EBMS, though, isn't an insurance company, is it?

A. No, it's not.

Q. And according to the charts that you use in your report, Blue Cross of Montana in the group market has about twice as much of a market share as everybody else combined and so I just wonder, based on that, how you -- what the basis of your conclusion that these small competitors are strong competitors is?

A. Well, we cite, as does Dr. Tardiff -- we cite some

examples of where there's been some turnover in some of the business and the fact that Blue Cross has lost some self-insured business over the years, so that there are some examples of competition, but also, I would give you sort of a broader sense of the evidence and that is they're suffering from underwriting losses.

It seems to me that if they have the market power that you seem to be implying because their share is twice as large as everybody else, that they would not have underwriting losses. They would not have reductions in their RBC. They would not be worried about the car running out of gas I guess is the metaphor yesterday.

There are some significant things that are worrisome and cause Blue Cross of Montana to seek an alliance with HCSC. And I think it's reflected -- the competition in this market is -- constrains Blue Cross of Montana from raising prices to where they can use -- where they can earn an underwriting gain.

Q. Now, according to your data, Blue Cross, over the last five years, has averaged a 91 percent market share in the individual market. Does your same analysis apply to the individual market, too, that is you also see strong competition in the individual market for Blue Cross in Montana?

A. Well, I guess I'll give you two levels of answer. One, the alternative to individual insurance is not be insured, so there actually is -- I mean, that's not -- we don't favor that one necessarily, but it does constrain the price that you could charge.

The second thing is that, as you know, there will be an exchange in which individual policies will be available, and that exchange will facilitate the distribution, if you will, of insurance products. So particularly going forward, the 91 percent -- I haven't looked to see if they're earning -- what they're earning on that segment, the individual segment, but I don't think there's any reason to believe that competition won't increase and that they will somehow become unconstrained in their prices of individual products.

Q. Even at a 91 percent market share?

A. Even at 91 percent.

Q. And I'm sorry -- I followed your point about the exchange, which I want to ask you about, but I didn't follow your first point when you said that something was constrained or constraining?

A. What I'm saying is that it's -- when people are choosing individual insurance, and this has happened over this recession. It's been fairly common across a lot of insurance companies. What you end up with is

people can't afford it. Then they just drop insurance.

I'm not saying that's a preferred solution, but it does act as a price constraint on what you can charge for individual coverage. And that was the first point I was making, and that going forward, we have the exchange, which is an efficient distribution of the individual policies.

Q. And we also have an individual mandate starting in 2014, right?

A. Yes, we do.

Q. Shouldn't have that some effect -- even if it's not as strong as many of us would like, shouldn't that have some effect on the likelihood that people will not buy insurance?

A. Oh, sure, but you also have this distribution system where they can presumably efficiently go to the exchange and determine what they're going to purchase or whether they're going to pay a penalty and not purchase insurance at all.

Q. But to the extent that the inability of people or the likelihood of people to drop out of the insurance market if prices are too high is a constraint on prices, that constraint is less powerful, isn't it, if there was an individual mandate involved?

A. Well, yes. I mean, they can pay a penalty. They

can still drop out. But I agree with you, that the trade-off changes, and those that will continue to buy, I am simply saying, have competitive alternatives efficiently listed on an exchange with perhaps new entrants like the co-op that I understand is being formed in Montana, for instance.

Q. Do you believe when exchanges do come online and the individual mandate is implemented and there are various penalties that apply, that there will be fewer people buying insurance in the group market and that some of them that are today in the group market will buy insurance in the individual market?

A. The answer is I really don't know. I believe that there can be some substantial shifts that people argue about now and make a wide range of estimates about, and that has to do with what number of employers, particularly small group, will decide I would rather pay the penalty and not insure my workers and let them go to the exchange.

And by going to the exchange a couple of things happen. They buy an individual policy, but many of them, depending upon their level of income, will get a subsidy from the federal government that is more than what the small business owner could have done for them.

There are -- I don't know the whole range of

estimates but there are a number of varying estimates as to who's going to basically drop out of the group insurance market, so my answer after that long explanation is I don't know.

Q. To the extent that more people do buy insurance in the individual market, though, a carrier with experience in the individual market would have an advantage in the new -- under the new system, wouldn't it?

A. Yeah, some. You're talking about a huge change. You're talking about people that are going to have to go to the exchange. And there will be, you know, web pages and the market will produce information and like a consumer's reports kind of information. And they'll talk about the ratings of this one or that one and there will be newspaper articles. It can be an advantage to know what you're doing in the individual market, but it's going to be a big change and there's going to be opportunity for a lot of others.

Q. Do you have an opinion as to whether the exchanges would work more effectively with benefit packages standardized at each metalevel or multiple benefit packages being sold at each metalevel?

A. Another great uncertainty. I mean, the answer is we've tried it in Medicare. In Medicare, we used to have Medicare Supplemental that went through A through,

what J or K, or 10 packages. Those packages got adversely selected and most states ended up with, you know, one or two of the packages. But those are standardized packages.

Standardized packages can be easier to search with but they can also lead to different kinds of problems. So, for instance, if what happened in Medicare, just to give the example, is that if you wanted drug coverage, you chose the high level. Well, the people who wanted -- the people who had essentially high levels of drug expenditures all chose the high level guide versus selected, and with the exception of Blues' plans in many of these states, almost everybody dropped it.

So I don't know the ACA rules well enough to predict that a standardized set of plan designs will also be adversely selected, but there's a lot of danger in all these changes and the danger is really for insurance companies and that's the risk we've been talking about.

Q. Now, you also concluded that HCSC's strong track record of improvement and maintenance of customer-facing web portals for its individual plans is a benefit, would be a benefit of the acquisition, correct?

A. Yes.

Q. What do you mean by that?

A. Well, there are some tools that HCSC has and uses

in its other divisions, and these are tools that are provider friendly, insurer friendly -- I'm sorry, provider friendly, broker friendly, employer friendly and one of them are these portals that make navigation easy.

Q. So by customer-facing web portals, do you mean a website that people can go to and get quotes for various insurance policies sold by HCSC?

A. I don't know what's all included in them. The answer is yeah, these are websites that people can contact and get some sort of information. I'm not sure what all the information is on it.

Q. Have you gone to any of these websites yourself?

A. I've gone to -- no, I've gone to the HCSC website and the Montana Blue website but I haven't gone to the portals. I don't know if I can even. I didn't try but I don't know if I can.

Q. So your source for that conclusion is basically interviews with HCSC people, right?

A. Yeah, reinforced a tiny bit by -- well, you even heard some of it here yesterday, but by the one broker that we did talk to who thought that technology was well worth looking forward to.

Q. Did you talk with the head of the agent's association in Montana?

A. No.
Q. But you talked to one individual broker?
A. Yes. We tried to talk to three but we only got ahold of one.
Q. And where is he or she located?
A. Billings.
Q. And then you also concluded that HCSC's MEDicision care management programs bring best practices care to chronically ill patients and reduce medical expenses. Did you -- how did you come to conclude that MEDicision brought best practices?
A. Well, just understanding what the software does, and that that's an understanding through interviews.
Q. So again, your source for that statement is interviews with HCSC management?
A. Yes.
Q. Now, you also conclude that the alliance will cause Blue Cross of Montana to pay a premium tax on its fully-insured business. How do you come to that conclusion?
A. I don't think it's stated as a conclusion. It's stated as -- it's stated as if it does, then it won't -- then competition will constrain and it will be passed on.
Q. Could you turn to page 7 of your Community Impact

Report. It's the third bullet. And read the first sentence.

A. Page 7, third bullet. Read it aloud?

Q. Please.

A. Even though the alliance will cause Blue Cross/Blue Shield of Montana to pay a premium tax on it's fully-insured business, Blue Cross/Blue Shield of Montana will not be able to pass the tax on to its members in the form of higher premiums since Cigna and UnitedHealth already pay that tax and have it built into their already competitive premiums.

Q. And I'm just asking you about the first part of that statement. This is an issue that I think you can understand many people are interested in, and so I just wonder how you came to state that even though the alliance will cause Blue Cross to pay a premium tax on it's fully-insured business, certain things would happen?

A. Well, I guess maybe it comes from further understanding. That sentence probably should have said may cause because I think there's some issue about whether it does trigger or won't trigger -- will trigger or also somewhere else in this report, we talk about how it might change even if it did trigger it.

Q. And did you talk to HCSC management about that?

Did they tell you that they thought they would be paying a premium tax in Montana?
A. I think it was HCSC management but I'm not sure, or Blue Cross of Montana.
Q. It was either HCSC or Blue Cross?
A. One of the two.
Q. Then you also talk about an agreement that Blue Cross made in its settlement of the recent New West litigation and the consequences of that being that HCSC will not sign exclusive contracts with independent brokers in Montana. Do you remember that?
A. Yes.
Q. Can you explain what that's all about?
A. Well, it was in the settlement. My understanding of that is that it won't sign contracts with brokers such that they only sell Blue Cross/Blue Shield of Montana; that these brokers would also sell the new New West, meaning the PacificSource version of New West once the -- once New West was broken up.
Q. And your understanding is that's a provision of the settlement?
A. I think it was in the settlement.
Q. Okay. And this is a settlement of what issue?
A. I'm probably not the one to explain this to you, but the general outline is that New West sought to be

taken over. The New West was an insurance entity created by I think five hospitals, five Montana hospitals, maybe some other entities as well. And they -- I believe they came to Blue Cross, asked them to take over the membership.

The Department of Justice stepped in and the settlement was essentially a split where Blue Cross would take the hospital-based members that were already -- that wanted to be insured by Blue Cross of Montana and that PacificSource was brought in as a divestment buyer for the remainder of the New West lives.

Q. When you say the Department of Justice stepped in, what do you mean?

A. They stepped in saying that the merger troubled them and they wanted to make sure that they could assure that competition in the future would be robust by creating a new entrant in PacificSource into Montana. They were here but they weren't here this big, this large.

Q. Another potential benefit of the acquisition, isn't it, is that there will be some money that will go to a foundation, right?

A. From the New West deal?

Q. No, I'm sorry, from the proposed acquisition of Blue Cross of Montana by HCSC?

A. That's my understanding, yes.
Q. Okay. And have you looked at any foundations in any other states that have been created as a result of convergence?
A. I'm -- in California, I'm -- I don't know if I would call it a member, but I get the newsletter every day or week from the California foundation, which was created when the original formation of WellPoint in California, so sort of but not really, not in any survey sense.
Q. And you also concluded that HCSC has successfully integrated Blue Cross plans in New Mexico in 2001 and Oklahoma in 2005, right?
A. Yes.
Q. Okay. And did you -- did you talk to anyone from Blue Cross of Montana -- of New Mexico or Oklahoma about the integration process down there?
A. No. We talked with HCSC management and asked a lot of questions about it but we didn't talk to the people on the ground in those states.
Q. Okay. So your source for that is -- that conclusion is HCSC management?
A. Interviews, extended interviews.
Q. Interviews with HCSC?
A. Yes, that's right.

Q. And you also say that Cigna won the Montana State employee business, right?
A. Yes.
Q. Have you heard that Blue Cross of Montana was just a few minutes late with its application so it didn't apply to -- apply to be the service provider for the Montana business in that case?
A. I did hear that that's what happened.
Q. Now, you've been -- you've been an expert in several matters involving health insurance companies, right?
A. Yes.
Q. Okay. And one was PacifiCare-FHP?
A. Yes.
Q. Was this a merger?
A. Yes. Acquisition, yes.
Q. And who were you retained by there?
A. In that case, PacifiCare.
Q. And you were also involved in the Aetna-Prudential merger?
A. That's correct.
Q. And who were you retained by there?
A. Aetna.
Q. And then you were also involved in the United-PacifiCare merger?

A. Yes.
Q. And who was your client there?
A. Well, in all these, it's counsel for these parties but it was on behalf of PacifiCare.
Q. And then Cigna and Great West you were also involved in. Who were you retained by there?
A. Counsel for Cigna.
Q. And then also you mentioned Cigna-HealthSource. Who were you retained by there?
A. Counsel for Cigna.
Q. And in any of these transactions, did you conclude that the transaction could raise entry barriers?
A. I don't believe entry barriers were an issue. There was some divestitures in some cities, but I don't believe there were -- I don't believe the issue was entry barriers.
Q. And in any of these transactions, did you conclude that the transaction was likely to substantially lessen competition in any way?
A. Well, absent the divestitures which were an issue, the answer is no, they would not substantially lessen the competition.
Q. And based on our previous discussion, I guess you didn't conclude that in any of those transactions, the company's market share would be so high that it would be

likely to result in increased prices?
A. That would be a substantial lessening of competition. Correct, I did not conclude there would be a substantial lessening of competition
Q. In any of these matters, did you conclude that there was likely to be an adverse community impact in any way?
A. That was not part of the scope of my assignment. It was the antitrust review by the federal and sometimes state antitrust agencies.
Q. Okay. And in your career, approximately how many health insurance mergers have you been retained in connection with?
A. I don't know, a lot, many that don't go through, many that seek advice, many where we tell them they'll have problems if they try to merge.
Q. A couple of dozen?
A. Yes, sir.
Q. A hundred?
A. I don't think a hundred. Maybe. I don't think a hundred.
Q. And have you ever been retained by either the federal or state government in connection with a merger?
A. Yes. The State of Montana retained me for the Certificate of Public Advantage, and I worked with

Attorney General Mazurek to develop a regulation for the Benefis Hospital.

Q. Have -- I'm sorry. Go ahead.

A. Which was the result of a merger.

Q. Have you ever been retained by a state or federal government entity that was reviewing -- that was reviewing a proposed merger?

A. I guess I would say that was a review of a merger as well but--

Q. Other than the Montana, the Montana issue, the Montana situation aside?

A. No. People in my healthcare practice have, but I have not.

MR. ANGOFF: I have no further questions. Thank you, Dr. McCarthy.

THE WITNESS: Thank you.

HEARING EXAMINER LEAPHART: Miss Hubbard.

MS. HUBBARD: No questions, your Honor.

HEARING EXAMINER LEAPHART: Mr. Kaleczyz.

MR. KALECZYZ: No.

HEARING EXAMINER LEAPHART: Miss Witt?

MS. WITT: No questions, your Honor.

HEARING EXAMINER LEAPHART: Any redirect?

MS. LENMARK: Just a few questions, your Honor.

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REDIRECT EXAMINATION

BY MS. LENMARK:

Q. Dr. McCarthy, you were asked a number of questions about Dr. Galasso's report, and I recall your testimony being that you had not read that report; is that correct?

A. That is correct.

Q. And so the representations of that report were the opinions that were stated to you, you don't have any personal knowledge of; is that correct.

A. I do not.

Q. And your responses would have been relying upon the characterization that was provided to you in the question?

A. Absolutely.

Q. You were asked a series of questions about pricing, insurance pricing in other states. Is it your understanding that all states price their insurance rates and premiums in the same manner and under the same law?

A. No, they do not.

Q. In fact, they each state prices separately under its own state law; is that correct?

A. That is correct.

Q. Is it also your understanding that Montana -- that

HCSC and Blue Cross/Blue Shield of Montana price in this state under Montana's regulations and laws?

A. Yes.

Q. And is it also the Montana experience that guides that pricing or is it national experience?

A. I think it's Montana experience. That's the law they have to abide by.

Q. Mr. Angoff clarified in one of his questions that EBMS was not an insurer. Do you know what type of entity EBMS is?

A. My understanding is that they are a TPA, a third-party administrator, which brings together a network and in this case deals a lot with associations, which are sort of aggregations of small businesses and finds an insurance product for them or manages the insurance product for them. They usually self-insure as an association.

Q. And do you consider EBMS a competitor of Blue Cross/Blue Shield of Montana in your report?

A. Yes, TPAs and rental networks usually work hand in hand, are definitely competitors.

Q. You were asked a question about the premium tax in Montana and were clarifying the report about whether there was a certainty that it would -- would retain -- HCSC would be paying the premium tax or not. And would

you tell me again your clarification about that statement.

A. Well, I think probably I shouldn't have said will. It should have said may. But other than that, it was our understanding and has always been my understanding that it may or may not happen, it may or may not change even if it does happen for some short period of time.

Q. And would the result of whether it does pay a premium tax or not pay a premium tax change the ultimate conclusions of your report?

A. No, not at all.

Q. In that series of questioning, you were asked where you got your information. And I believe I heard your statement to be, your response to be that you received that from HCSC. Your footnote reflects that the information came from Blue Cross/Blue Shield of Montana. Do you recall information, certain information that could resolve that discrepancy?

A. If I cited it in the -- my memory is wrong then. Whatever I cited in the paper would be the right reference.

Q. When you were discussing the successful integrations that HCSC has managed in other states, you indicated that you got your information from HCSC. When you stated that, did you mean that those conclusions

were dictated to you by HCSC or were those conclusions inferred from information you obtained in the interviews?

A. Certainly, the latter was what I tried to say. These were extensive interviews where we probed a lot of things.

Q. And finally, Dr. McCarthy, you talked about the loss of the State of Montana contract that Blue Cross/Blue Shield lost the bid on just recently. And it was pointed out that that was a result of a delay in filing the application. Does the fact that the loss of that contract happened as a result of the delay change your conclusions about the competitive market in Montana and the effect of that competition on Blue Cross and Blue Shield of Montana?

A. No, it does not -- it's not -- I don't know whether Cigna would have won the contract anyway. I just know what I learned was that the Blue Cross proposal was not accepted.

MS. LENMARK: I have no other questions, your Honor.

HEARING EXAMINER LEAPHART: Thank you. Further cross?

BY MR. ANGOFF: Just a minor point or two

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RECROSS-EXAMINATION

BY MR. ANGOFF:

Q. It's not the case, was it, that Blue Cross's proposal wasn't accepted, it's the case that Blue Cross did not make the proposal because it's too late, right?

A. And that's what I meant, it was not accepted as in received. I think we're probably saying the same thing.

Q. I think we probably are. Can we agree that Blue Cross did not submit a proposal?

A. In effect, they did not submit a proposal because it was not accepted as timely by the State.

Q. Very good. Thank you.

And then secondly, EBMS is not a competitor in the individual market, is it?

A. I don't believe it's in the individual market. No, TPAs usually are not.

Q. It couldn't be a competitor in the individual market because it's a TPA, right?

A. You would have to find somebody to bear the risk of the insurance.

Q. And you can't do that in Montana?

A. I've never heard of aggregations of individuals as the way small groups and employers are aggregated.

MR. ANGOFF: Nothing further.

HEARING EXAMINER LEAPHART: Miss Hubbard?

MS. HUBBARD: No, your Honor.

HEARING EXAMINER LEAPHART: No further questions?

MS. LENMARK: No, your Honor.

HEARING EXAMINER LEAPHART: You may step down. Call your next witness.

MS. LENMARK: Your Honor, the parties have had a discussion and have come to an agreement that it might be more convenient for the experts to take Dr. Tardiff's testimony now, and so the State will be calling Dr. Tardiff.

HEARING EXAMINER LEAPHART: Okay. Mr. Laslovich.

MR. LASLOVICH: Yes, your Honor, the State calls Dr. Timothy Tardiff.

HEARING EXAMINER LEAPHART: Good morning.

THE WITNESS: Good morning.

TIMOTHY J. TARDIFF, Ph.D.,

a witness, after having been first duly sworn, testified upon his oath as follows:

DIRECT EXAMINATION

BY MR. LASLOVICH:

Q. Dr. Tardiff, good morning.

A. Good morning, Mr. Laslovich.

Q. Will you state and spell your last name for the

record, please.
A. My name is Timothy J. Tardiff, and my last name is spelled T-A-R-D-I-F-F.
MR. LASLOVICH: Your Honor, if I may approach.
HEARING EXAMINER LEAPHART: Yes.
Q. (By Mr. Laslovich) Dr. Tardiff, I've handed you your Prefiled Testimony. Do you recognize that?
A. Yes.
Q. Have you had a chance to go through it?
A. In preparing it, yes.
Q. Do you affirm that that, in fact, is your prefiled direct testimony?
A. Yes.
Q. Thank you, sir.
MR. LASLOVICH: Your Honor, we would pass the witness.
HEARING EXAMINER LEAPHART: Cross-examination.
MS. LENMARK: We have no cross-examination.
HEARING EXAMINER LEAPHART: No need for redirect.
MS. HUBBARD: No questions, your Honor.
HEARING EXAMINER LEAPHART: Mr. Tardiff, you may step down.
THE WITNESS: Thank you, your Honor.
HEARING EXAMINER LEAPHART: Back to the

Applicant. Is that your agreement as far as the order of witnesses?

MS. WITT: We need to do a little chair shifting, your Honor.

HEARING EXAMINER LEAPHART: Okay.

MR. KALECZYZ: Thank you, your Honor.

We call as the next witness Colleen Reitan.

HEARING EXAMINER LEAPHART: Good morning.

THE WITNESS: Good morning.

COLLEEN REITAN,

a witness, after having been first duly sworn, testified upon her oath as follows:

DIRECT EXAMINATION

BY MR. KALECZYZ:

Q. Good morning.

A. Good morning.

Q. Would you state for the record your name and your position with HCSC.

A. My name is Colleen Reitan and I am Executive Vice President and Chief Operating Officer of HCSC.

MR. KALECZYZ: If I may approach the witness, your Honor.

HEARING EXAMINER LEAPHART: Yes.

Q. (By Mr. Kaleczyz) And Miss Reitan, what I handed you, is that your Prefiled Testimony dated March 5, 2013

in this matter?
A. Yes, it is.
Q. And you adopt that as part of your testimony in this matter today?
A. Yes, I do.
Q. Just a few other questions for you to supplement your testimony, if I may. Would you explain to Justice Leaphart briefly what generally your duties are as the Chief Operating Officer at HCSC.
A. As Chief Operating Officer, I am responsible for our Financial Services Division, our Information Technology Group, our Service and Claim operation, our management of overall project control, things like that, that Mr. Kadela spoke yesterday, and our Data and Analytics Group and we have a Government Programs Division that reports to me.
Q. And as part of your responsibilities and as the Chief Operating Officer, did you authorize on behalf of HCSC the entering into the stipulation with the Attorney General and Blue Cross/Blue Shield that was introduced into evidence yesterday as Exhibit 9 concerning the purchase price, remaining as a not for profit corporation and matters related to possible additional employees in Great Falls?
A. Yes, I did.

Q. And you're aware that the stipulated purchase price in Exhibit 9 is $40.2 million?
A. Yes, I am.
Q. And could you explain briefly why you agreed that HCSC would make a good faith commitment to remain a not for profit corporation for the next five years?
A. Well, certainly, the Judge heard Mr. Smith talk yesterday about his experience with the organization over 20 years, and our commitment to and devotion to the non-investor owned approach to managing it and running Blue Cross/Blue Shield plans, and I think I would be hard-pressed to add any more eloquence to what he said as to what that means to our employees. And that is certainly something that I support personally and our board supports, so it felt like it was a reasonable thing for us to agree to for that period.
Q. And in the stipulation that you agreed to yesterday, one of the contingencies is that the Commissioner of Securities and Insurance either approve the transaction or provide to the Attorney General and to the Applicants a commitment of that approval that is acceptable to the Applicants by March 30th, 2013. You recall that?
A. Yes, I do.
Q. And that contingency, in fact, does affect whether

additional employees may be added in the call center in Great Falls?

A. Correct.

Q. In your prefiled testimony, you made reference to a February date and here we've talked about a March date. Could you explain to Justice Leaphart what those two dates were all about and why the March 30th day is now relevant?

A. As we've began the process of considering this alliance with the Montana plan, one of the important parts of the way we operate is we put workforces in the states that we do business. And we also happen to be dealing with, at the same time, the preparation for the changes that are coming from the Affordable Care Act.

The open enrollment period begins October 1st of this year. And we happen to operate in two of the largest states in the country in Illinois and Texas, and they happen to have significant number of uninsured individuals, so we're making investments in order to be able to respond to that market. And we need additional workforce to help us support that.

So the timeline we're really dealing with is that October 1st open enrollment period, and in order to do that and to move my workforce around, I really need this provider services center to be up and running by August.

And so we simply backed the dates up from August to say when do we really need to know that we've got work underway or accomplish that change.

And I've been -- and originally, it was February. The objective, I'm trying to be as flexible as I possibly can and still be able to put a workforce in Montana. So I've been pushing our teams as to how late we can go in that process, and we're getting to a point of no return by the end of March with the issue.

Q. Now, one of the public witnesses that appeared yesterday was from Great Falls Development Authority. Were you present in the courtroom during his testimony?

A. Yes, I was.

Q. And he testified that sometime in -- on or about October 2, 2012, he was contacted concerning what he later learned to be was the possibility of an HCSC call center being placed in Great Falls. Do you remember that?

A. Yes, I do.

Q. And you did not sign the APA until sometime in November of 2012; is that correct?

A. Correct.

Q. Why were you involved in looking at a call center prior to the time you had executed the purchase agreement with Blue Cross/Blue Shield of Montana?

A. Well, as I mentioned, part of our model is to put workforces in the states that we do business. Today, I have my team, call center claims operations centers in our four states, and so as part of us thinking about entering into this at the purchase agreement, we wanted to make sure we understood the workforce and the economic conditions in the state of Montana before signing that, and we were satisfied with what we learned.

Q. A few further questions, Miss Reitan. Yesterday, did you also authorize that HCSC become a signatory to a second stipulation with Blue Cross/Blue Shield and the Attorney General?

A. Yes, I did.

MR. KALECZYZ: May I approach the witness, please, your Honor?

HEARING EXAMINER LEAPHART: Yes.

Q. (By Mr. Kaleczyz) Miss Reitan, is this, what's been marked as Exhibit 10, is this a copy of the stipulation that you had authorized be executed on behalf of HCSC?

A. Yes.

MR. KALECZYZ: I would move the admission of Exhibit 10, your Honor.

HEARING EXAMINER LEAPHART: Any objection?

MR. LASLOVICH: No, your Honor.

HEARING EXAMINER LEAPHART: It's admitted.

MR. KALECZYZ: With that, your Honor, we -- I would have no further questions and we would pass the witness for cross-examination.

HEARING EXAMINER LEAPHART: Thank you.

Mr. Laslovich.

Oh, sorry. Mr. Angoff.

MR. ANGOFF: You were complimenting me, your Honor.

CROSS-EXAMINATION

BY MR. ANGOFF:

Q. Good morning, Miss Reitan.

A. Good morning.

Q. You used to work for Blue Cross of Minnesota, right?

A. Yes, I did.

Q. For how long?

A. I started there in 1983 and ended as the Chief Operating Officer. I came to HCSC in 2008 .

Q. And what did you start as at Blue Cross of Minnesota?

A. I actually started in sales.

Q. And then what happened?

A. And then I went to work as a provider relations

negotiator.
Q. And then what was your next job after that at Blue Cross in Minnesota?
A. I think at that point -- this is 33 years, right, or more -- I left to go to graduate school. And then I was hired back by Blue Cross and worked for a number more years in their product development and product management area. And then I actually had children and was hired to work part-time for a surgical center, and then I went back.
Q. And ended up as the President?
A. I did.
Q. And then did HCSC steal you away?
A. Actually, at the time, I had an opportunity -- I was being pursued by both United Healthcare and HCSC. It was the fourth time I had been approached by United Healthcare, which is a publicly-traded company and it's just not in my core to do that, so I was very happy to go to HCSC.
Q. Now, at Blue Cross of Minnesota, while you were there, did Blue Cross of Minnesota ever community rate?
A. You know, I was not accountable for any of the underwriting and actuarial functions so I can't answer that. I don't believe so but I can't answer with any great confidence.

Q. Do you know whether they were ever the insurer of last resort in Minnesota? That is, do you know if they ever had a guaranteed issued product in Minnesota?
A. I know that the small group requirements required guarantee issue.
Q. Just for the small group market?
A. I don't believe that Minnesota had a guarantee issue requirement in the individual market except for the temporary policy and some in the small group market were.
Q. And was Blue Cross of Minnesota the administrator for the Minnesota high-risk pool?
A. Yes, it was for most of my tenure, but the last few years, it was not.
Q. And were you responsible for that? Well, if you were President, I guess you must have been.
A. I mean, I had a lot of responsibilities.
Q. I'll withdraw the question.
Do you know while you were at Blue Cross of Minnesota during any time, any part of your tenure, did Blue Cross of Minnesota have looser underwriting standards than the other carriers in the market?
A. I sure couldn't answer your questions. I don't know.
Q. And do you know whether they had more compressed

rating rules?
A. Than whom?
Q. Than its competitors. Do you know whether Minnesota -- for example, do you know whether Blue Cross of Minnesota would not charge older people more than -- as much more than younger people as its competitors?
A. No. As a matter of practice, as long as I've been in this business, having a level playing field, so all competitors are approaching the market rating on the same level playing field is very much the long-term interest of the market. And as long as I've been in this business at the organizations I've worked for have always strived for that.
Q. So as far as you know then, Blue Cross of Minnesota didn't do -- didn't have more -- less -- didn't have more compressed rates than its competitors?
A. Again, I think you're asking the wrong person. I really can't answer that question with a great deal of confidence.
Q. Did Blue Cross of Minnesota have a target underwriting profit or loss each year while you were there?
A. You know, I think the target -- concept of target is fascinating to me because both there and at HCSC, the rating occurs very much in granular levels; that that

rolls up into a business plan. Often, the overall business plan has an overall objective of its necessary margin in order to maintain its reserves or grow reserves or invest in the future, and it was a similar approach in Minnesota as it is to -- at HCSC.

Q. So then at Blue Cross of Minnesota, then if there was an overall business plan -- is that what you called it?

A. Yes.

Q. Okay. And was there a -- whether you call it a target or a goal, was there a level of underwriting profit that Blue Cross of Minnesota wished to obtain?

A. Again, it was typically at the net income level. So underwriting is one element, but there are other elements, whether it's through subsidiaries or investment earnings, all aimed at a net gain after tax, again to allow you to replenish your reserves or invest in your company for the future.

Q. And Blue Cross of Minnesota then did have a target net gain?

A. It was an outgrowth of the business conditions at the time and depended a great deal on what you were trying to accomplish, so every year was a little different as a result of those factors.

Q. Okay. And so in the last few years you were

there, what was your target net gain?

MR. KALECZYZ: Your Honor--

THE WITNESS: I don't recall.

MR. KALECZYZ: Your Honor, excuse me.

Excuse me, Mr. Angoff. I'm not sure what the relevance of all of this examination concerning Minnesota Blue Cross plans from several years ago is at this point. Your Honor, we'll let it go on for a while but we'll object to the relevancy.

MR. ANGOFF: I'll move on, your Honor.

HEARING EXAMINER LEAPHART: All right. Thank you.

Q. (By Mr. Angoff) You're now with HCSC?

A. Correct.

Q. And you're now -- and what's your current position with HCSC?

A. Executive Vice President, Chief Operating Officer.

Q. And when you first came to HCSC, your title was a little different, wasn't it?

A. Right.

Q. And what was that?

A. It was Executive Vice President of Information -- or Internal Operations and Financial Services.

Q. Okay. And then is your current title simply a change in title or additional responsibilities, too?

A. There are additional responsibilities and a change in title.
Q. Okay. And so what were your responsibilities when you first came to HCSC?
A. All the things I had mentioned earlier except for I did not have the analytic function and I also didn't have the Government Programs Group.
Q. Okay. And now as Chief Operating Officer, you oversee many things, obviously. Maybe a better way to do it would be to talk about the things that you don't oversee. But financial reporting is one you do have?
A. Correct.
Q. Underwriting?
A. Correct.
Q. And the actuaries?
A. Yes.
Q. And compliance?
A. No.
Q. Provider relations?
A. No.
Q. Agent relations?
A. No.
Q. Government relations?
A. No.
Q. But financial, underwriting and actuarial?

A. They report to the Chief Financial Officer, who reports directly to me.
Q. All right. So you're familiar then with the filing of HCSC's annual statements?
A. I know that we file annual statements, yes.
Q. And you don't prepare them yourself?
A. No, and I don't sign them either.
Q. But the people -- but you are -- but the people who prepare them and do sign them are reporting either directly or indirectly to you?
A. Correct.
Q. And you're generally familiar with annual statements?
A. Generally. I love them.
Q. You've read an annual statement?
A. I have read parts of annual statements.
Q. Do you file the annual statement with the NAIC?
A. I don't know the answer. I know we do file it with the State of Illinois.
Q. And do you know, is there just one HCSC's annual statement that's filed with each of the states in which you own a Blue Cross plan or are they different HCSC annual statements filed in different states?
A. You can imagine because of the broad accountability I have and the responsibilities of the

Chief Financial Officer, I can't answer that question with any degree of specificity

Q. So you--

A. I don't know.

I don't know.

Q. So it might be the case that there are different -- as far as you know, it might be the case that there are different HCSC statements, annual -- there's a different HCSC statement filed in New Mexico?

A. I'm not saying that and no, I don't know.

Q. You have no idea?

A. I don't know.

Q. Are you familiar with the Department of Health and Human Services medical loss ratio?

A. Yes, I am familiar with the medical loss ratio being a requirement.

Q. And do you know whether HCSC has filed data with the Department of Health and Human Services regarding its medical loss ratio for 2011?

A. If it's required, I'm sure we have.

Q. And do you know whether HCSC has met the HC -- the MLR threshold specified in the HHS medical loss ratio for all its business?

A. Are you talking about 2011?

Q. I'm sorry, can you--

A. Are you talking about 2011?
Q. For 2011, correct?
A. We have 12 rating areas so we operate in 4 states and there are 3 thresholds of this medical loss ratio rebate requirement, so we have basically 12 situations and in 9 of the 12, we did not pay any rebates but in 3 of the 12 areas we did in 2011.
Q. And do you know what states and what markets, though, you did pay a rebate in?
A. My recollection is that in Texas, the individual market we did, and in Oklahoma was the individual and small group market I believe.
Q. Okay. And do you know what medical loss ratio you targeted in those states in which you ended up paying a rebate?
A. You know, since the new requirements to rebate any dollars that aren't at those MLR threshold levels have gone into effect, our goal is to rate right around the threshold so either 80 percent for the individual and the small group or the 85 percent for the group size.
Now, we're in a transition period. Dr. McCarthy referred to the one coming, but we're in one now and so it sometimes takes a little while to transition which is why the example from Texas, the individual market had a lower medical loss ratio prior to this new rebate

requirement, and we've been gradually trying to increase it but the objective was to get it as close as it possibly could be to those medical loss ratios with the rebate.

Q. Do you know approximately how much you had to rebate for the year 2011?

A. I don't recall the exact amount and it varies quite a bit per person. I would have to go back and look it up. I don't remember the exact amount.

Q. Could it be close to a hundred million?

A. I don't think it was -- it was somewhere -- it was somewhere between 85 and 95 I believe, but I don't know the exact number.

Q. And do you expect to pay a rebate in -- for the year 2012; do you know?

A. You know, because the rebate rule allows this kind of what's called a three-month run out of your claims expense, we don't know for certain but we're anticipating we will be facing -- we will be providing another rebate in Texas, again, because Texas individuals have taken up a little bit of time to get that medical loss ratio up.

Q. But not in the other states?

A. I don't know for certain. I believe there are probably one or two other segments but again, there's a

couple more months of claim run out that occurs before we know for certain.

Q. Do you know why that is that you're paying -- are you paying or you did pay a rebate in Texas and you think you might in 2012, but in the other states in general, you haven't and you don't expect to?

A. Because we didn't -- because the medical loss ratio was either at or above the 80 percent for the individual and the small market or 85 percent for the group market.

Q. In the states in which you didn't pay the rebate?

A. Right.

Q. In Texas, it was below that?

A. Slightly below that.

Q. You don't file a 10-K with the SEC, right?

A. We are not a publicly-traded company, so no, we don't.

Q. But is there an HCSC annual report?

A. We have our statutory statements that are filed with the regulators, correct.

Q. There's the annual statement--

A. Correct.

Q. --which we're talking about?

But does HCSC also publish any type of annual report which it makes available to the public or its members?

A. Our annual statement is our public information and it's available because it's public information.
Q. Okay. But there's no HCSC report with pictures and graphs and four colors that's like a 10-K type annual report?
A. We do annual reports of our community impact and things like that, certainly.
Q. I'm sorry, I'm a little hard of hearing--
A. I'm sorry.
Q. --so could you speak up a little bit.
A. I feel like I'm talking loud.
Q. It's not your fault. It's my fault.
So you said there are certain reports. What type of reports?
A. They're like community giving reports, things like that, annual reports.
Q. But nothing would be like an annual report that would be -- that is in effect a 10-K?
A. We don't file 10-Ks because we're not a publicly-traded company.
Q. But are you familiar with the annual reports that publicly-traded companies file?
A. Certainly.
Q. Okay. And does HCSC publish anything in the nature of that type of report?

A. Our annual statement which goes to the regulators which is public information.
Q. The annual statement--
A. Yes.
Q. --being the annual statement that we initially talked about--
A. Yes.
Q. --that's filed with the regulators?
A. Yes.
Q. Are you familiar with financial examinations performed by state departments of insurance?
A. Certainly.
Q. Okay. And so are you examined regularly by the -- is HCSC examined regularly by the Illinois Department of Insurance?
A. Yes, we are.
Q. And how frequently?
A. Again, I'm not 100 percent sure but I know they do at least three year periods, and it often takes them a year to do three years so it feels like they're there quite often.
Q. Sure. It feels like they work there. But the people who work with the state insurance departments on those reports, do they report either directly or indirectly to you?

A. Typically, they're managed by our compliance organization. They do not report to me, no.
Q. And do you know, are you examined by the other three states in which you do business?
A. I don't know the answer to that question.
Q. And do you know whether you're examined by any other states?
A. Other states?
Q. Other states than the four in which you--
A. I don't know the answer to that.
Q. And do you play any role in connection with these examinations?
A. I can be -- I've been interviewed, certainly, by the examiners.
Q. Now, HCSC prepares a financial plan each year, correct?
A. Right.
Q. And are you involved in the preparation of that?
A. I am.
Q. I'm sorry?
A. Yes, I am. I'm sorry.
Q. And what is your involvement?
A. Reviewing the assumptions that go into it, thinking through the investments and the objectives that the organization has for the coming year and then

understanding kind of the reasonableness of the plan. And then my team presents it to our board for their approval.

Q. Okay. And this plan includes a budget for operating expenses, I would assume?

A. Yes.

Q. And it includes projected investment returns?

A. Yes.

Q. Okay. And projected taxes?

A. Yes.

Q. Okay. And projected underwriting gain?

A. Enrollment, underwriting gain, change in business, all kinds -- it's just lots of assumptions, yes.

Q. And so for your most recent financial plan, I guess that would be for the year 2013?

A. Correct.

Q. So what was your projected underwriting gain in that financial plan?

A. You know, I don't recall the underwriting gain. I do recall the net gain after tax which was about $650 million.

Q. Your projected net gain after tax was $650 million?

A. Right.

Q. That is substantially less, isn't it, than your

actual net gain for 2012, isn't it?
A. Correct.
Q. And so why do you project that it would be less?
A. The biggest reason is the preparation for the Affordable Care Act and investments that the company needs to make in order to be prepared.
Q. Okay. And as a percentage of premium, what underwriting gain would you project in your 2012 financial plan?
A. I believe that is something under one percent.
Q. For 2013, your projected underwriting gain was--
A. I'm sorry, the projected net gain after tax is something under one percent.
Q. Right. And my question is, what was your projected underwriting gain?
A. I don't recall the percentage.
Q. It was more than one percent, though, wasn't it?
A. Typically, yes, if you have investment income and other subsidiary and you have to pay taxes, because of taxes, your net is going to be less than what your underwriting gain will be.
Q. And in your financial plan, is there also a projected surplus?
A. It's a result of the underwriting gain and the estimation of your enrollment changes so it's not really

a projection, it's more of a resulting measure.
Q. Okay. And so what was your estimated surplus in your most recent financial plan?
A. You know, I don't recall but I will tell you at 650 -- at 650 million, it would be approximate to a reduction in our surplus. As you grow your insured business and claims expense go up, we have to earn close to a billion dollars a year to stay even at the RBC level of the previous year, so at 650, it would have been a drop in the RBC level.
Q. Say that again. You've got to earn close to a billion dollars a year?
A. To stay even.
Q. To keep your surplus level?
A. Yes, because we're a very big company.
Q. And do you -- you've just got one big amount of surplus, right? Surplus isn't allocated to each of your four states, is it?
A. Correct.
Q. Have any of the state insurance departments asked you to allocate surplus to their states?
A. I don't know the answer to that question.
Q. You've never heard any discussion of that issue?
A. No. Again, I haven't. It doesn't mean it hasn't been asked. I'm saying I don't know the answer to that

question.
Q. And you have a projected underwriting gain by state?
A. Yes, we do.
Q. Okay. And what was that -- what were your projected underwriting gains by state in 2012?
A. 2012 or '13?
Q. First 2012.
A. I don't recall the projection, but they do vary significantly because our states are quite different in their makeup of their business, their size. We typically have underwriting gains in Illinois, underwriting gain estimates or projections in Illinois and Texas that are in the, you know, in Illinois a couple hundred million and Texas, it's maybe less than that. In new Mexico, because it's a small plan, we often project either break even or loss situations. And Oklahoma has changed a bit over the years as they grow.
MR. KALECZYZ: Your Honor, with this line of questioning, I don't know, but it sounds like we may be getting into confidential and proprietary information with respect to the projections and budgets for future years. Miss Reitan is probably in a better position than I to ultimately make that determination, but if, in fact, we are headed in that direction, we would ask that

you close that part of the proceedings.

HEARING EXAMINER LEAPHART: Would you like to take a break and prepare--

MR. KALECZYZ: I would appreciate that.

HEARING EXAMINER LEAPHART: --that aspect?

MR. KALECZYZ: Yes, I would, please.

HEARING EXAMINER LEAPHART: Let's take a 10-minute break.

(Whereupon, a brief recess was taken.)

HEARING EXAMINER LEAPHART: Let's reconvene.

MR. KALECZYZ: Your Honor, during the break, Mr. Angoff and I conferred about the line of questioning that he is moving toward and we've agreed that for purposes of the immediate line of questioning, there is confidential and proprietary information in the view of HCSC, and we would ask that the room be cleared as it was yesterday, the same stipulation in effect as yesterday.

MR. ANGOFF: And the principle, your Honor, is this, for forecasts, the position HCSC is taking is that that should be confidential, which for purposes of this hearing, we agree to. We do not want that to be taken by anyone as our -- as any -- as our acceding to the position it really is trade secret.

HEARING EXAMINER LEAPHART: The same

understanding we had yesterday?

MR. ANGOFF: Yes, sir. But the things that aren't -- aren't forecasts, those aren't confidential and I've got one question that doesn't involve the forecast and then a series that do involve the forecast. So can we go ahead with the one question?

HEARING EXAMINER LEAPHART: You're okay with the non-forecast?

MR. KALECZYZ: As long as Mr. Angoff is asking questions about actual performance, we don't have any problem with that. When he is asking for either forecasts for 2013, 2014, or alternatively, if he's asking, for example, what was forecasted in 2011 for your 2012 financials, that, again, we would have an issue with. And so even if it's forecasts that were made in prior years, we would ask that that be sealed. Questions about actual performance, we don't have a problem with.

HEARING EXAMINER LEAPHART: Did you have some question as to actual? You can proceed with those.

MR. ANGOFF: Just one.

Q. (By Mr. Angoff) Miss Reitan, we talked about a surplus, an allocated surplus to different states, and I forget exactly where we were but I wanted to know whether any insurance commissioners had asked HCSC to

allocate surplus to their states, and I forget what your answer was?

A. I don't believe so but I don't know for certain.

Q. Okay.

MR. ANGOFF: Your Honor, may I have this marked?

HEARING EXAMINER LEAPHART: Yes, you may.

Q. (By Mr. Angoff) Miss Reitan, I've handed you what's been marked as Commissioner's Exhibit B for identification and ask whether you can identify it?

A. This is the -- are the minutes from the December 9th board meeting of HCSC.

MR. KALECZYZ: Excuse me, your Honor, this document, as it indicates on the face of it is confidential and proprietary information. To the extent that Mr. Angoff is going to ask any questions about that, I think we've now reached a point in the proceedings where they should be closed to the public pursuant to the agreements we had yesterday and discussed a few minutes ago.

MR. ANGOFF: That's fine with us, your Honor. I just would first like to move what has been marked as Commissioner's Exhibit B into evidence as Commissioner's Exhibit B.

HEARING EXAMINER LEAPHART: Is there any

objections to Commissioner's Exhibit B?

MR. KALECZYZ: We have no objection, your Honor, provided that, again, this exhibit be sealed along with the testimony that I think Mr. Angoff is about to elicit.

HEARING EXAMINER LEAPHART: Any objection from the Attorney General's Office?

MS. HUBBARD: None, your Honor.

HEARING EXAMINER LEAPHART: It's admitted. So pursuant to that stipulation, at this point, I would ask that everybody other than the attorneys involved in this matter please retire to the lobby and that the doors be closed.

(Whereupon, a portion of the proceedings were sealed.)

(Whereupon the following proceedings were held in the presence of the Public.)

HEARING EXAMINER LEAPHART: Let the record reflect that the public has been invited back into the courtroom and are present for any further examination.

MR. ANGOFF: Thank you, your Honor.

CROSS-EXAMINATION (Cont.)

BY MR. ANGOFF:

Q. Miss Reitan, you're in charge -- did you say you're in charge of the team which is negotiating the

terms of the transaction between HCSC and Blue Cross of Montana?

A. Yes, I am.

Q. Okay. And you are one of the people, weren't you, that met with Blue Cross of Montana people on June 11th in Three Forks, Montana, right?

A. Yes, I was there.

Q. And what did you understand the purpose of that meeting to be?

A. I understand the purpose was for the Board of Directors of the Montana plan to talk to us and potentially other Blue Cross plans about their interest in a possible alliance.

Q. And did you know that Blue Cross -- did you think that Blue Cross of Montana was meeting with any other companies at about the same time?

A. We were not told that directly but we guessed that that was the case as well.

Q. Did you think that there was more than one company involved?

A. I knew there was definitely at least one more. It could have been more than that.

Q. And did you think that the other company was the company that we referred to in this proceeding as Company X?

A. I have no way of answering that.
Q. You don't know who Company X is?
A. I'm not a hundred percent sure, and I don't know.
Q. Now, there were several issues to be negotiated between Blue Cross and HCSC, correct?
A. Correct.
Q. Okay. And as the head of the team, what were your biggest concerns in the negotiations?
A. It's kind of a broad question. Do you have something more specific?
Q. No, just what was -- in talking to Blue Cross of Montana about a possible affiliation, what was most important to HCSC?
A. Well, I think we've said earlier that one of our objectives as a non-investor owned Blue Cross plan to try to find a way that we can help other Blue Cross plans interested in staying non-investor owned meet their needs for the future, and so this was an opportunity to have a conversation with a like-minded Blue Cross plan.
Q. Okay. And other than the document that we were earlier just previously discussing, did HCSC ever estimate or retain anyone else to estimate the value of Blue Cross of Montana?
A. We didn't, and we didn't with that one either.

Q. Well, what -- I thought you had never seen that document?
A. Well, I think it was represented in the cover letter and reflecting in the cover letter, what the cover letter said. I'm reflecting what the cover letter said.
Q. Other than that cover letter, you have no personal knowledge one way or the other about that report?
A. Right, correct.
Q. Did you ever look at any other type of -- in the course of your negotiations with Blue Cross of Montana, any comparable companies, any companies that were comparable to Blue Cross of Montana?
A. No, other than the fact that the Blue Cross/Blue Shield of New Mexico plan had some similarity to it at the time that that asset agreement was signed.
Q. Okay. Did you -- you weren't at HCSC when Blue -- when the acquisition of Blue Cross of New Mexico and Oklahoma occurred, right?
A. Correct.
Q. But did you look at how much HCSC paid for Blue Cross of New Mexico and Blue Cross of Oklahoma?
A. Incumbent in the relationship to the transaction, I became aware of it, yes.
Q. And did you convert that into

a per covered life or per member cost?
A. I don't think that was the methodology.
Q. So did there come a time when Blue Cross and HCSC agreed that the price that HCSC would pay would be determined by an expert valuation?
A. In any business transaction, as I understand it -- I'm not a transaction expert -- the understanding of what each party is looking to accomplish and the environment that they're operating in, particularly when it comes to Blue plans, you have to take all that into account and you have to, in this case, had to take into account the conversion statute and what it dictated.
Q. And so did there come a time when HCSC and Blue Cross of Montana agreed that the value -- that the price that HCSC would pay would be determined by a third party valuation?
A. The methodology we agreed to use was to gain an independent valuation of the fair market value as was required by the conversion statute. And then HCSC reserved the right to either enter into that valuation with the Montana plan or not.
Q. You agreed to -- am I correct in understanding that you agreed to purchase the Blue Cross of Montana assets subject to a price to be determined?
A. We agreed to approach this with a fair market

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value valuation, independent valuation to set the price which was what we believed the conversion statute told us we needed to do.

Q. But did you -- did you understand that you would be bound by whatever the valuation was or did you believe that you were free to walk away?

A. Well, it was an independent valuation and it was gotten by the Montana plan and then we, after getting it, we either accepted it and that became the purchase price or we could have not and not gone ahead with the alliance.

Q. You could have rejected it?

A. We could have not gone ahead.

Q. And did you have any discussions as to what the valuation would have to be in order for you not to go ahead with the transaction?

A. No.

Q. Okay. At what price would you have walked away from the transaction?

A. Well, as we looked at the transaction, we thought about three -- you know, a number of factors. One was certainly the purchase price. The second one was the fact that we were going to be leaving a surplus behind and knew that the minute the members of the Montana plan became our members, we would have to cover their surplus

requirements, so that was something that's been on our mind. And part of our thinking about what the value -- what the right value is or how much we would pay.

And then the last piece certainly is what it costs to convert and invest in another Blue Cross plan in another state. So all those three factors played together for us in terms of what becomes a reasonable or unreasonable overall cost.

Q. Sure. And at what price would you have walked away from the transaction?

A. You know, I think we're probably there.

Q. I'm sorry?

A. I think we're there. We've agreed -- we've stipulated a 40.2 million price, and we think it's in the range of a reasonable fair market value, and given the other expenses that we are anticipating, it is about as far as I can go from an authorization standpoint.

Q. The valuation that you originally agreed to was 17.6 million, correct?

A. Correct.

Q. Okay. And then how did you go from 17.6 million to 40.2 million?

A. There was a valuation that was done by the State as part of their process, the Attorney General's Office, and also within our valuation, there was an upper end

range, so the ranges all appear to converge and it made sense to us that this is a fair market value.

Q. So the 40.2 million is still within the range of the--

A. Correct.

Q. --of the valuation?

Did HCSC ever consider having an investment banker value Blue Cross of Montana?

A. No.

Q. Have you had investment bankers value other companies that you were acquiring?

A. I have not been involved in them. Others at HCSC may have but I have not.

Q. Do you know how -- and I know you weren't at the company at this time, but do you know how HCSC determined how much it would pay for Blue Cross of New Mexico?

A. I don't know.

Q. And do you know how much -- how HCSC agreed how much -- how much H -- do you know how HCSC determined how much it would pay for Blue Cross of Oklahoma?

A. I don't know.

Q. Now, once the Affordable Care Act takes full effect in 2014, there will be restrictions on both underwriting and rating, correct?

A. Correct.
Q. Will HCSC then have less use for actuaries and underwriters? That sounds too harsh. Will actuaries and underwriters have fewer responsibilities because of the mandated rating and underwriting regime under the Affordable Care Act?
A. Personally, I think it's the equal employment act for actuaries and for financial people, to be honest with you.
Q. So you're not worried about your actuaries needing things to do?
A. No.
Q. Now, the Affordable Care Act prohibits insurers, doesn't it, from using health status in rating after 2014?
A. Correct.
Q. But can you still use a wellness program as a rating factor?
A. I believe that there may be some ability to use whether people smoke or not and maybe a few other factors but I don't know if there's much beyond that.
Q. Okay. And are you familiar with the wellness programs that HCSC currently uses?
A. To some degree, yes.
Q. What are they?

A. That's a pretty broad question.
Q. Well, what -- in connection with your rating methodology, what types of -- what program would enable someone to get a decrease if he or she complied with it and/or would get an increase if he or she didn't?
A. You know, again, we are in the process of putting all of our products and rates together for ACA and lots is still in flux and I'm also not an actuary so I can't answer that question.
Q. I'm not asking you about the future but currently. I'm asking currently, do you know what wellness programs you have in place?
A. Not with great specificity, no.
Q. Did you read Mr. Galasso's valuation?
A. Not completely, no.
Q. What did you read of Mr. Galasso's valuation?
A. Some of the summary.
Q. Okay. And are you aware that he estimated that the average increase in cost for the first year after the Affordable Care Act is in effect, that is the increase in the riskiness of the book of business would be 25 percent in the individual market and 18 percent in the small group market?
A. I did not -- don't recall that, but it doesn't surprise me.

Q. So that sounds reasonable?
A. It could be. That could be higher. There's a lot of uninsured young people with a different illness burden and it depends a lot on which state and market you're particularly talking about.
Q. But does that sound reasonable to you?
A. Again, it might as an overall average, but we don't rate on overall averages. We rate on specific markets and specific rating areas so I don't think you can extrapolate one to the other.
Q. So it could be higher; it could be lower?
A. Correct.
Q. Are you going to need a broker network to sell through the exchanges?
A. Our plan is to do both, sell both direct through, you know, web-based tools and through the exchanges and also to use insurance agents. We think they're going to play an important role, particularly during the market transition period.
Q. Do you know whether people who buy without an agent would pay a lower price than people who buy through an agent?
A. Again, I'm not as sure about all of our approach to our rate setting at this stage of the game so I can't answer that question.

Q. Before you agreed to -- before HCSC agreed to enter into this transaction with Blue Cross of Montana, did you have any concerns about the costs possibly not being worth -- the benefits possibly not being worth the cost because of Montana's small size?
A. Certainly, we weighed a number of factors and because of our fiduciary duty to our policyholders, we had to make sure we made a good business decision. So there were a number of factors, but at this stage of the game, we feel okay about where we are.
Q. And in all your other states, in the three other states where what used to be Blue Cross of Illinois acquired the Blue Cross plans, there's been substantial growth, correct?
A. Correct. And there is still a Blue Cross/Blue Shield of Illinois.
Q. I stand corrected. Thank you.
Do you have any reason to expect that there wouldn't be substantial growth of Blue Cross of Montana?
A. Again, it's a little hard to tell because we haven't done any market projections or significant work on the Montana market and also because everything is changing because of ACA.
Q. You've done no analysis of the Montana market?
A. You know, I personally, when we first got the call

from Montana, I looked up the Montana statutes, the census statistics and tried to get a sense of the state and in terms of geo -- demographic statistics, things like that. And then you certainly heard that we've done some analysis of workforce in the state of Montana but beyond that, really, no, we have really not done any more.

Q. So you've agreed to purchase the Blue Cross of Montana assets in this case for $40.2 million but you haven't looked at the competition that Blue Cross has in Montana?

A. At a cursory level just because of conversations with the Blue Cross plan here, certainly, but, you know, we are -- this is an asset purchase. We're purchasing the insurance business of Blue Cross/Blue Shield of Montana. We are in the insurance business, and we're in the individual market and the small group market and the group market. We know this business pretty well. And we are not an investor-owned group plan and they are as well, so with some pretty high level review, we can have an understanding of the market.

Q. Would you have entered into this transaction if you didn't believe that you could grow the business in Montana?

A. Yeah, we may have.

Q. And how would that be a benefit to -- if you couldn't grow the business of Montana, how would that benefit -- why would you enter into the transaction?
A. Because we have other objectives as a company. You know, I mentioned before that we're a non-investor owned mutual company, and we believe in the model and we also believe that the Blue Cross approach or having a Blue Cross plan available for every geography in the country is a good thing, and so some of our objective is related to that purpose and mission and some of it is a business objective, but it's pretty strongly also that purpose and mission.
Q. So you would enter into this transaction at least in part for altruistic reasons?
A. You bet.
Q. The members of HCSC own the company, right?
A. Correct.
Q. Okay. And so the members are also the policyholders, correct?
A. The policyholders are the members.
Q. And the policyholders get -- have certain benefits by reason of being policyholders, right? They -- under the contract that they have, they get certain benefits, correct?
A. Correct, but you're going to be -- I'm, again, not

a lawyer and I'm not a structure -- not a person who understands structure to a significant degree, so I do know that we're a mutual and that we have policyholders and that they elect our board of directors.

Q. Okay. And do you know what benefits members get by reason of their status as members?

A. I couldn't answer beyond what I just did.

Q. And do you know when, if at all, the members meet?

A. Annually.

Q. And do you know when the last time is that they met?

A. I think it might have been in February.

Q. And do you know what action the members take at their annual meeting?

A. I know they elect the board of directors.

Q. Do you know whether they make any other decisions?

A. Again, I'm not the best person to answer that question so I don't know.

Q. And have you ever gone to any of the members' meetings?

A. I have, yes.

Q. When was the last one that you went to?

A. I think I went this year.

Q. I'm sorry?

A. I think I went this year.

Q. And so at that meeting that you attended, the members elected -- did you remember that -- do you remember whether they, the members, elected a board of directors?
A. They elected the board of directors, the members of the board whose term was up and open for reelection, yes.
Q. And do you remember whether the members at that meeting took any other action?
A. I don't recall.
Q. You don't remember them specifically taking any other action?
A. I don't remember.
Q. We've heard a lot about a possible facility in Great Falls, Montana that HCSC would open if this transaction closed, correct?
A. Correct.
Q. And in your testimony and your prefiled testimony, you said that if we didn't do it -- if you couldn't -- if HCSC couldn't make final plans by the end of February, that would be too late, correct?
A. Well, can you tell me what page.
Q. Sure, it's right at the end of your testimony, page 19, the first paragraph.
A. So can I read it?

Q. Please do.
A. HCSC must have additional facilities along with the trained workforce ready for the new insurance exchange enrollment that begins in October of this year. To accomplish that objective, HCSC must begin finalizing its customer service center plans later this month, February in quotes. If HCSC does not open a center in Great Falls or in Montana, it will need to open an additional center in another location in one of our states.

I think the key thing here is we were finalizing our plans for customer service in February.

Q. It was impossible in February, wasn't it, to finalize plans that would include a Great Falls facility because you didn't know whether there would be a Great Falls facility?
A. Well, I sure hoped we could have known. The original hearing was set for the 12th and we were really hoping we would have a better indication within the month of February, certainly. And the reason is because of ACA, if for no other reason.

We have a lot of expansion. We have a thousand open positions today in our company. And the problem is ACA has an October 1 deadline and it is not going to move, so we can't move either. We have to get this work done.

Q. And how did you go from saying you had to begin finalizing your customer service center plans later in February in your prefiled testimony to what you said -- what was in the stipulation that was entered into between -- among HCSC and Blue Cross and the Attorney General's Office two days ago where the deadline is now March 30 by which you must finalize customer service plans?

A. Well, and again, this statement refers broadly to customer service plans, just to be clear, in my prefiled testimony. But, you know, we have -- our objective is to have that call center open and able to start taking calls in August of this year, so you just back it up from then, try to figure out when you have to have people trained and ready to go; therefore, when you have to start their training, when you need to do their hiring, where you're going to do their training and then how the call center will be made available in time.

So I refer -- I rely on my teams that do this work to tell me what time do you need to get this work done. And the first answer you always get is I'll take as much time as you can give me, and then you push them a little bit harder, and because of the change of events here, I've been pushing them. And we enter -- you know, it would have been -- we would have made less commitments

by the end of February.

We're already into some commitments and we need to make more commitments. We get to the point of no return by the end of March.

Q. So as of today, you're saying the point of no return is March 30th?

A. Correct.

Q. And so what do you need -- what -- what is HCSC requiring the State of Montana to commit to in order for HCSC to provide a hundred jobs in Great Falls?

A. You know, again, I'm not a lawyer and so I don't know enough about kind of what technically or legally this might translate into, but I understand that, you know, actual closing of a company takes a lot longer. There may be some procedural things that need to be accomplished. But as a businessperson, I need an understanding of whether HCSC is highly likely to be doing business in Montana because, if we are, we would like to begin putting more employment here.

Q. So if HCSC does not believe that it's highly likely that -- if HCSC by March 30th does not believe that it's highly likely that the transaction will close, then it's too late to establish this facility in Great Falls for this year?

A. It's a real missed opportunity. I will say up

until the continuance that occurred, I didn't have my teams working on a Plan B. This was my Plan A and I didn't have a Plan B, but we're doing some other contingency planning in case it doesn't look like it's going to happen.

Q. So unless Health Care Service Corporation does not believe by March 30th of this year that it's highly likely that the transaction will be approved, then it will be too late for HCSC to establish a facility in Great Falls for the upcoming year; is that correct?

A. It would be too late without us spending money that we wouldn't be able to ultimately use, which I would prefer not to do.

Q. So March 30th then is not a drop-dead date?

A. No, it's a pretty heavy drop-dead date. People want to start doing remodeling and start doing hiring fairs and things like that. And I really don't want to do those things. I think that would be imprudent and unfair to people if we did, so it really is a point of no return.

Q. So by point of no return, you mean if the State of Montana does not assure HCSC by November -- by March 30th, that the transaction will close, HCSC will not open the facility in Great Falls?

A. I think I said that I'm looking for high

likelihood or a level of comfort that we'll be doing business here, and I said I don't know what that means in terms of legal terminology or other steps that could be taken.

Q. Sure. But if you don't have that level of comfort by March 30th, then there will be no facility in Great Falls?

A. As a businessperson accountable for this, it would be -- yes, make me very uncomfortable.

MR. ANGOFF: Thank you, your Honor.

Thank you, Miss Reitan. And that's all I have.

THE WITNESS: Thank you.

HEARING EXAMINER LEAPHART: I would like to ask a question, if I could. Does the opening of the facility in Great Falls go hand in hand with the asset purchase? Can they -- is there the possibility that you could go ahead with the asset purchase even if you couldn't open the facility in Great Falls?

THE WITNESS: Yes. Yes, we would. But it's such a great opportunity to begin our workforce expansion here because we do need to expand our workforce, so I'm not saying that we wouldn't go ahead with the asset purchase, I'm just saying I've got these deadlines I need to meet and I need an employee base.

HEARING EXAMINER LEAPHART: Thank you. Miss

Hubbard.

CROSS-EXAMINATION

BY MS. HUBBARD:

Q. Miss Reitan, is it your understanding that HCSC and Blue Cross/Blue Shield can walk away from this deal, withdraw their application at any time?

A. I believe there's -- I know we entered into a stipulation and I'm not recalling the specific details of that.

Q. Would it help you if you had the stipulation in front of you?

A. It would, thank you.

Q. Take your time in reviewing it. I'm just asking for your appreciation of whether HCSC and Blue Cross/Blue Shield could walk away from the deal?

A. I guess I read on the second page, number -- under 6B, it appears -- the way I would read this is up until the March 30th date, we are obligated to continue and after that, we wouldn't be under any obligation. That would be the way I would read it.

MS. HUBBARD: Thank you.

MR. MCMAHON: Nothing for Blue Cross, your Honor.

HEARING EXAMINER LEAPHART: Redirect.

MR. KALECZYZ: We have no redirect, your Honor.

HEARING EXAMINER LEAPHART: Okay. Thank you, Mrs. Reitan. You may step down.

MR. KALECZYZ: Your Honor, we're going to do a little shuffle of seats for a moment.

HEARING EXAMINER LEAPHART: Do you need a break?

MR. KALECZYZ: No, we don't need a break, your Honor.

HEARING EXAMINER LEAPHART: Mr. Laslovich.

MR. LASLOVICH: I would like a short break if I may.

HEARING EXAMINER LEAPHART: Ten minutes.

MR. LASLOVICH: That would be great.

HEARING EXAMINER LEAPHART: Ten minutes after three.

(Whereupon, a brief recess was taken.)

HEARING EXAMINER LEAPHART: It's 3:10. Are we ready to proceed?

MS. WITT: We are, your Honor. The Applicants calls James Galasso.

HEARING EXAMINER LEAPHART: Good afternoon.

THE WITNESS: Good afternoon.

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JAMES P. GALASSO,

a witness, after having been first duly sworn, testified upon his oath as follows:

DIRECT EXAMINATION

BY MS. WITT:

Q. Would you state your full name and spell your last name for the record, please.

A. James P. Galasso, G-A-L-A-S-S-O.

MS. WITT: May I approach the witness?

HEARING EXAMINER LEAPHART: You may.

Q. (By Ms. Witt) Mr. Galasso, I'm going to approach you and hand you a document entitled Direct Testimony of James P. Galasso dated February 8th, 2013. Is that testimony that you prepared in connection with the application that brings us here today, Mr. Galasso?

A. Yes, it is.

Q. And do you adopt that testimony in connection with these proceedings as it is written?

A. Yes, I do.

Q. Have you been made aware that Blue Cross/Blue Shield of Montana, Health Care Service Corporation and the Montana Attorney General have stipulated for purposes of this action that $40.2 million represents a fair market value of the purchased assets?

A. Yes, I am.

MS. WITT: Pass the witness, your Honor.

HEARING EXAMINER LEAPHART: Thank you. Commissioner.

MR. LASLOVICH: Thank you, your Honor.

HEARING EXAMINER LEAPHART: Mr. Laslovich.

MR. LASLOVICH: Would you give me a second, your Honor, to get organized.

HEARING EXAMINER LEAPHART: Okay. That podium is hard to work from.

MR. LASLOVICH: It's awful.

HEARING EXAMINER LEAPHART: It's a gem.

MR. LASLOVICH: Pardon me? Yes.

CROSS EXAMINATION

BY MR. LASLOVICH:

Q. Mr. Galasso, good afternoon.

A. Good afternoon.

Q. It's really good seeing you again. I appreciate you coming to Montana.

A. Thank you.

Q. You and I spoke briefly during one of the breaks, Mr. Galasso, and I want to just make sure that it's clear in the record. Some people have referred to you as Dr. Galasso, some have referred to you as Mr. Galasso. I want to make sure I refer to you appropriately. Is it Dr. Galasso or Mr. Galasso?

A. Mr. Galasso.
Q. Okay. Thank you, sir.
Mr. Galasso, do you have a copy of your report that you did on behalf of Blue Cross/Blue Shield of Montana?
A. No, I do not.
Q. We're going to get into some questions about your report. Would it assist you to have a copy of that report once we get into those questions?
A. Yes, it would.
MR. LASLOVICH: Your Honor, if I may approach.
HEARING EXAMINER LEAPHART: You may.
MR. LASLOVICH: And this is a part of the application, your Honor, so I'm presuming I don't need to have it marked as an exhibit and admitted.
HEARING EXAMINER LEAPHART: It's in the record.
MR. LASLOVICH: Okay.
HEARING EXAMINER LEAPHART: Would you remind me which number, if you know.
MR. LASLOVICH: I will tell you.
THE CLERK: 5.
HEARING EXAMINER LEAPHART: 5.
MR. LASLOVICH: Yes, your Honor, Tab 5. Thank you.
Q. (By Mr. Laslovich) Mr. Galasso, have you had a chance to briefly look at your report that I've just

given you?
A. Yes.
Q. Is it your full report that you prepared for Blue Cross/Blue Shield of Montana which is attached to the application?
A. Well, this is the one marked Privileged and Confidential, and I know we had -- let me just check one page. I hate to say this, but I think there was a subsequent version to this report that was ultimately filed.
There was a little expansion of that section.
Yeah, I have the final report.
MR. LASLOVICH: I really apologize, Mr. Galasso, and your Honor.
HEARING EXAMINER LEAPHART: Mr. Galasso, feel free to move that microphone so you can access the report.
THE WITNESS: Thank you.
MR. LASLOVICH: Forgive me. I thought I was being smart and getting the one that was marked because we had page number issues, and clearly I got the wrong one, so I apologize.
Q. (By Mr. Laslovich) Before we get into that report, Mr. Galasso, you're an actuary, correct?
A. Correct.

Q. You've been an actuary for a long time, correct?
A. Yes.
Q. And you've never done work for Blue Cross/Blue Shield of Montana prior to doing this report; is that correct?
A. That's correct.
Q. But you have done work for some Blue Cross/Blue Shield clients across the country; is that correct?
A. That's correct.
Q. You were previously employed by Blue Cross/Blue Shield of Florida; is that correct?
A. Correct.
Q. And subsequent to that employment, you consulted for Blue Cross/Blue Shield of Florida; is that correct?
A. Correct.
Q. And then also consulted for Blue Cross/Blue Shield of Louisiana; is that correct?
A. Correct.
Q. And Blue Cross/Blue Shield of Michigan; is that correct?
A. That's correct.
Q. Blue Cross/Blue Shield of Mississippi; is that correct?
A. Correct.
Q. Blue Cross/Blue Shield of Kentucky?

A. Correct.
Q. Blue Cross/Blue Shield of North Carolina?
A. Correct.
Q. Blue Cross/Blue Shield of South Carolina?
A. Correct.
Q. Blue Cross/Blue Shield of Georgia?
A. Correct.
Q. Blue Cross/Blue Shield of Hawaii?
A. Correct.
Q. And some consulting work for the Blue Cross/Blue Shield Association; is that correct?
A. Correct.
Q. To your knowledge, have I missed any Blue Cross plans that you've done consulting work for in the past?
A. Probably just say WellPoint, which covers several Blue Cross/Blue Shield plans.
Q. So that report that you have in front of you, Mr. Galasso, is dated November 9th, 2012; is that right?
A. Correct.
Q. And what was your understanding of what you were supposed to do when you were contacted by Blue Cross/Blue Shield of Montana?
A. Evaluate -- conduct a cash flow analysis of specified contracts that were presented to me for evaluation.

Q. Did you know -- let me just back up.
Did Blue Cross/Blue Shield of Montana tell you that they were going to use your valuation as part of a potential acquisition?
A. They said they were considering an acquisition, yes, and it might very well be part of that.
Q. But you didn't know who the potential acquirers were; is that right?
A. That's correct.
Q. And when you did your report, you had discussions with Blue Cross/Blue Shield of Montana management; is that right?
A. Correct.
Q. And the purpose of those discussions were to ensure that you had, I'll use the word "reasonable" assumptions in your report; is that correct?
A. That's correct.
Q. And--
A. I should also say also reasonable factual data, factual assorted data.
Q. Very good. Thank you.
And am I correct that your primary point of contact at Blue Cross and Blue Shield of Montana when you were doing your work was Jim Spencer, the chief actuary, for Blue Cross/Blue Shield of Montana?

A. He's the person I spent most of my time with, yes.
Q. And am I correct in saying that you certainly relied on some of the assumptions that Blue Cross/Blue Shield of Montana submitted to you during the course of your work?
A. Relied on -- I guess I would consider it consultation, that we had back and forth discussion and ultimate agreement as to what were reasonable assumptions.
Q. Okay. You talked briefly in your deposition about your modeling, and I just want to briefly ask you a couple of questions about your modeling. You're the founder of your company; is that correct?
A. That's correct.
Q. And as founder of your company -- correct me if I'm wrong -- you were the one who created the Optimizer?
A. That's correct.
Q. And can you just tell -- let me go to the next question and then we'll try to explain. You also created the Segmenter; is that correct?
A. That's correct.
Q. Can you tell us just briefly and to the extent you can in layman's terms what those two models are.
A. I will make it very brief and obviously, if you have any more detailed questions, I would be happy to

answer as detailed as you like. But basically, the Segmenter takes historical information, and I was provided 30 months of month by month historical information for the nine business segments that I was asked to evaluate. And from the Segmenter, that gets exported to data.

The actual historical data gets exported into what I call the Optimizer, which is the projection model. And the projection model then projects the cash flow on a going forward basis. That is the present value of those cash flows are what are used to develop the appraisal value in my report.

Q. It's not simple, is it, Mr. Galasso?

A. No, it's my most complicated model by far.

Q. Mr. Galasso, I'm going to ask you to turn to your report, if you will. The copy that you have doesn't have a page number.

A. Mine has page numbers.

Q. It does? If you refer to the exhibits?

A. Okay, refer to exhibits. No, you're right, the exhibits are missing the page numbers. I'm sorry.

Q. Mr. Galasso, I'm sorry, did you say your exhibits were page numbered?

A. No, I was incorrect. The report was page numbered but the exhibits are not.

Q. Okay.

MR. LASLOVICH: Your Honor, if I may approach Mr. Galasso.

HEARING EXAMINER LEAPHART: You may.

MR. LASLOVICH: Your Honor, I'm a little embarrassed so forgive me. I thought I had this great plan of having the report that I gave to him which had the numbered pages. Clearly, that wasn't the right report, so I was unprepared to have copies available of certain exhibits that are within his report identified as certain exhibits.

In conferring with counsel, I think it would be easier for all of us if I had copies made of those exhibits that I want to use with Mr. Galasso so that we all can be on the same page.

HEARING EXAMINER LEAPHART: That's fine.

MR. LASLOVICH: So if I can just have two minutes to make these copies, your Honor.

HEARING EXAMINER LEAPHART: Is it going to help facilitate matters if you go through and put page numbers, handwrite them in or--

MR. LASLOVICH: That has been done, but really, I think this would be perhaps--

HEARING EXAMINER LEAPHART: Okay.

MR. LASLOVICH: --more simple.

HEARING EXAMINER LEAPHART: Let's do it then.

(Off the record briefly.)

MR. LASLOVICH: Your Honor, thank you for your patience.

HEARING EXAMINER LEAPHART: You may resume.

MR. LASLOVICH: If I may have this marked, your Honor.

HEARING EXAMINER LEAPHART: All right.

MR. LASLOVICH: If I could give it to the witness, if I can approach.

HEARING EXAMINER LEAPHART: Sure.

Q. (By Mr. Laslovich) Mr. Galasso, I've handed you what's been marked as Exhibit F. Do you recognize that?

A. Yes, I do.

Q. And was that included in your report that you did for Blue Cross/Blue Shield of Montana?

A. Yes, it was.

Q. And this is--

HEARING EXAMINER LEAPHART: I take it since this is already in the application, there's no objection to it?

MS. WITT: No objection.

MR. LASLOVICH: Your Honor, I wasn't going to move to admit, but I'm happy to do that.

HEARING EXAMINER LEAPHART: I just wanted to be

clear.
Q. (By Mr. Laslovich) This sheet is a summary of the scenarios that you ran in the Optimizer and Segmenter; is that correct?
A. The Optimizer, yes.
Q. The Optimizer. Excuse me. And the appraisal date is as of January 1st, 2013; is that right?
A. Yes, that's correct.
Q. And you also, didn't you, run some scenarios through the Optimizer with an appraisal date as of June 30th, 2012; is that correct?
A. Well, the appraisal date of June 30 was driven off of the January -- it wasn't run through the Optimizer separately. It was these numbers discounted by six months to June 30.
Q. Okay. Very good. I appreciate that.
But you did -- you did an average of scenarios with an appraisal date as of June 30, 2012; is that right?
A. Correct.
Q. And that is included within your report and based on that average, your average of those four scenarios as of June 30th, 2012 was approximately $17.6 million; is that correct?
A. That's correct.
Q. And that number represents, Mr. Galasso, doesn't

it, the initial purchase price that HCSC was willing to pay for Blue Cross/Blue Shield of Montana's core business? Is that your understanding?

A. I think that goes beyond my knowledge. I submitted the report and I wasn't privy to any negotiations or understanding in terms of purchase price.

Q. Well, Miss Witt asked you under your direct whether you knew about the $40.2 million. You said yes.

A. I was made aware of it, right.

Q. And did you know what the purchase price was before the $40.2 million?

A. I don't think I can -- that I recall knowing that 17.6 was an acknowledged purchase price, just that it was the average of my scenarios

Q. Oh, very good. Okay.

So turning then, Mr. Galasso, to Exhibit F, the average of those scenarios with an appraisal date of January 1st, 2013 is approximately $18.6 million; is that right?

A. Correct.

Q. And it's also correct, isn't it, that it's just the average of Scenarios 1 through 4 and you're not including Scenario 5; is that right?

A. That's right.

Q. And in Scenario 5, you're accounting for the nonassignability of provider contracts; is that correct?
A. That's right.
Q. And the reason you're accounting for the nonassignability of provider contracts is because Blue Cross/Blue Shield of Montana told you that the provider contracts that they've entered into would not be assignable to an acquirer; is that correct?
A. That is correct.
Q. And Blue Cross/Blue Shield of Montana gets a discount for entering into these provider contracts; is that right?
A. That's right.
Q. And the discounts that you included in your report for professional fees, they get 34.3 percent, a 34.3 percent discount. Does that sound about right?
A. Yeah, I would have to look at the report, but that sounds about right.
Q. If I represented to you that's what you had in your report, does that sound about right?
A. Right.
Q. And then how about for hospitals, about 16.7 percent discount, does that sound about right?
A. Yes.
Q. And for prescriptions, for pharmacy of about 54.5

percent discount, does that sound about right?
A. That does sound correct.
Q. So due to those contracts not being assignable, does that lower the value of Blue Cross/Blue Shield of Montana?
A. I certainly think so. Yes, it's one of the first things that an acquirer, in my mind, would look for are the provider contracts.
Q. So if -- based on your modeling, if HCSC were to get the same discounts that Blue Cross/Blue Shield of Montana currently gets with its providers, the value under your modeling would increase $4.7 million; is that right?
A. Well, if I could expand a little bit on that, is the modeling that I did, I considered two possibilities for valuing prior contracts. One methodology I used was to assume deterioration of the discounts and what impact that might have.
A second methodology I considered but rejected just because I couldn't get my hands on data that I thought would be credible would be to just try and identify what expense an acquirer might have to go through to renegotiate all the contracts and then a judgment call as to whether or not they could achieve the same level of discount or not. But whether they get the same level

of discount or not, I would assume an acquirer would have to go through a fair amount of expense.

Part of this thinking methodology that I used was to try to get at the issue that someone coming in is going to have to put a lot of work to renegotiate contracts. And the four and a half million dollars that I came up with using this methodology seemed like a reasonable outcome to me for that extra work.

Q. Okay. I appreciate that.

So you assumed, didn't you, in your analysis, that a potential acquirer would get about half of the discount, the discounts that Blue Cross/Blue Shield of Montana--

A. That's right.

Q. --currently receives; is that right?

A. That's what I used for the model to develop these assumptions, correct.

Q. So assuming I understand what you said about the additional expense that a new acquirer would have in entering into new provider contracts, but assuming that they got the same discounts, the value -- does the value under your modeling increase?

A. The model -- well, the model -- if they got the same level of discounts, the model would produce what you see here for Scenario 5, the 28 point -- for Scenario 5 versus Scenario 1, 28.5. I'm sorry, 28.8

versus 24.0. But I would think I would want to assume something in the way of expenditures which might be something similar to the differential that we're looking at here. That's all I'm trying to find there.

Q. Okay. So that I understand you then, just because they could get the same discounts, you're saying that that doesn't necessarily mean that the value increases another $4.7 million. Is that what you're saying?

A. Right, it could be some other number based on the expense to reneg -- I assume it would still be an expense to renegotiate the standard thousands of contracts.

Q. Right. So your estimate then would be that it's about $4.7 million expense for a potential acquirer to renegotiate those contracts?

A. That seems -- both things seen reasonable to me. I couldn't quantify the expenditure, when I came up with 4.7, 4.5, the June 30 value. I thought it passed the credibility test of reasonableness.

Q. When you did this, Mr. Galasso, you didn't know that Blue Cross/Blue Shield of Montana was in discussions with HCSC; is that right?

A. That's -- when I did all the work-work. When I did the report, I obviously did because I put something in the summary saying I'm aware that Blue Cross is now

in discussion with HCSC, but when I was doing the work, I was not aware.

Q. Does your assumption change if Blue Cross/Blue Shield of Montana and all the people who are at Blue Cross/Blue Shield of Montana go to HCSC?

MS. WITT: I'm going to object to the ambiguity of the question. I'm not sure whether the question is would your assumption change if you were doing a fair market valuation or would your assumption change in some other way.

HEARING EXAMINER LEAPHART: What's the context?

MR. LASLOVICH: Well, I'll rephrase the question. Miss Witt is going to keep me on my toes, your Honor, and making sure that I'm asking specific questions. Let me try to be clearer.

Q. (By Mr. Laslovich) Mr. Galasso, would your -- you testified that your -- the difference of $4.7 million is a result of the expenditures an acquirer would have to make to renegotiate contracts; is that right?

A. Well, I'm saying that there were two ways you could look at it. You could look at the expenditures and you would probably have to go through, or you could look at the contracts just become null and void and the acquirer is losing all the discounts, percentages of discounts. There are different assumptions you can

make.

I was just trying to say that I don't think a reasonable assumption is that given -- if you -- if we can assume these contracts are, in fact, nonassignable, I don't think it would lead to the assumption that what you are trying to ask me, that an acquirer can come in on day one and without any expenditures at all have those discounted contracts in place on day one. I'm saying that doesn't seem like a realistic assumption to me.

Q. Okay. And so -- and I appreciate that.

So how about if the acquirer is retaining Blue Cross/Blue Shield of Montana, would that change the fair market valuation?

A. If they retain Montana in the contracts?

Q. I'm sorry, if Blue Cross/Blue Shield of Montana remains the same, the only difference essentially is that they're, in this instance, they would be a division of HCSC?

A. But the contracts stay intact?

Q. Let's assume the provider contracts stay intact.

A. Yeah, I mean, if Blue Cross/Blue Shield of Montana is, you know, stays as is, provider contracts as is, I would probably go with Scenario 5 for that hypothetical.

Q. And assuming -- okay.

All right. Turning, Mr. Galasso, to Scenario 1 on Exhibit F. I'm correct to say that Scenario 1 is your base scenario?

A. Yes. Maybe I should clarify. When I said I would go with Scenario 5, I meant in lieu of Scenario 1, I would pick Scenario 5.

Q. I appreciate that. Thank you.

Scenario 1, Mr. Galasso, again back to my initial question, is your base scenario. Is that what I understand?

And let me clarify, if I can. Clearly, when you look at Scenarios 2, 3 and 4, you're saying the same as Scenario 1 except you're making various adjustments. That's what I mean by your base scenario.

A. That's correct, right, as long as -- I didn't mean it to be my best estimate or anything like that, but the base scenario, the scenario was well derived, correct.

Q. Right.

So in base Scenario 1, you are including an 8 percent -- and we'll get into this a little further in some of the other exhibits. But in base Scenario 1, Mr. Galasso, your 8 percent slash 13 percent discount rates, the 8 percent represents the discount rate for existing business, correct?

A. Correct.

Q. And by existing business, I mean Blue Cross/Blue Shield of Montana's existing business, correct?
A. Right, on the assumed date of acquisition, correct.
Q. Correct.
And then the 13 percent discount rate is for new business, right?
A. Correct.
Q. Okay. Turning then to 75 percent, 2014, individual/small group lapse replacement ratio. Do you see that?
A. Yes, I do.
Q. And we'll get to that in a little bit, and I'll ask about that later. I just want to make sure I have all the assumptions in base Scenario 1.
Then the next assumption is 75 percent extended period lapse replacement ratio, right?
A. Correct.
Q. And then the next one is low individual/small group medical loss ratios; is that right?
A. Yes.
Q. And then the next assumption is the agent commissions are reduced by one percent; is that correct?
A. Correct.
Q. And then also, because of space, what I

understand, you have an assumption with regard to administrative expenses in base Scenario 1?

A. Yes. And I don't think they changed by scenario.

Q. Right. I'm just making sure--

A. Oh, yes, correct.

Q. --what we're assuming in Scenario 1, and we'll get to your--

A. I was going to say in addition to space, they change. I didn't feel the need to itemize it.

Q. I appreciate that.

And then also included in Scenario 1 is an assumption regarding medical trends; is that right?

A. That's correct.

Q. And then to your knowledge, are there any other assumptions? We have the four or the five I guess that you have printed, the two additional ones. Anything else that we have not covered that would be -- that you had as an assumption in base Scenario 1?

A. Did you mention medical loss ratio?

Q. Yes.

A. If administrative expenses includes premium taxes, the ACA fees, there were assumptions revolving around that as well. I think that's all.

Q. Okay. And I'm not trying to be sneaky about it, I just want--

A. I understand. I just wanted to be complete myself.
Q. Yeah, I appreciate it.
All right. Mr. Galasso, then--
MR. LASLOVICH: Your Honor, if I could have an additional page marked.
HEARING EXAMINER LEAPHART: Yes.
MR. LASLOVICH: If I can give it to the witness, your Honor.
Your Honor, if I could approach you. This is supposed to be G.
Q. (By Mr. Laslovich) Mr. Galasso, I've handed you what's been marked as Exhibit G. Do you recognize that?
A. Yes, I do.
Q. And that was -- was that also included in your report for Blue Cross/Blue Shield of Montana?
A. Yes, it was.
Q. Okay. Mr. Galasso, so if we just look at the top box there, Medical Loss Ratios. This document and in particular the Medical Loss Ratios that we're going to discuss in that top box, they're related to your assumptions that you make in base Scenario 1 that we just discussed; is that right?
A. That's correct.
Q. Okay. So am I fair -- well, let me back up.

The assumption that you make in 2013 in the individual market for medical loss ratio is 83 percent; is that right?
A. Correct.
Q. And then turning, going to 2014, it's 85 percent, correct?
A. Correct.
Q. All right. When you were preparing this analysis, you consulted with Blue Cross/Blue Shield of Montana on the medical loss ratio assumptions?
A. Yes, I did.
Q. Yes, okay.
And do you recall the range of medical loss ratio assumptions that you discussed with Blue Cross/Blue Shield of Montana?
A. The only thing I can -- I believe I recall is that we ended -- that these were lower than all the other ones we considered.
Q. So, the -- okay.
A. I believe that's true. It may not be a hundred percent, but to the best of my recollection, that's true.
Q. Do you think, Mr. Galasso, that you would have gone down to 82.44 percent for medical loss ratio?
A. Instead of 83 point zero?

Q. Correct.
A. I suppose with enough discussion. I don't know if I could distinguish the difference between the two.
Q. So did I understand you then, that at least in 2013, the 83 percent number is the lowest?
A. Yes. I mean, and the reason -- I feel it's a very low number, and I think it's the lowest one, like I said, that we discussed really in practical terms is because it was running in excess of 83 percent for the first six months of 2012. The first six months of the calendar year in Blue Cross/Blue Shield Montana's history has always been much more favorable than the second six months.
So I was assuming that calendar year 2012 was going to come in substantially above 83 percent if we assumed 83 percent for 2013, improvement, a significant improvement in 2012, what I assumed would be 2012.
Q. And do you know what the 2012 medical loss ratio ended up being?
A. No, I don't.
Q. In 2014 in the individual market, you have a medical loss ratio of 85 percent, right?
A. Correct.
Q. And did you also consider a range for medical loss ratio in the individual market in 2014?

A. Yeah, again, I think we had originally started substantially higher than that with concern over the implementation of the Affordable Care Act.
Q. And by substantially higher, what do you mean?
A. I can't say as I recall, but I would think 87 to 88 percent.
Q. And did you go lower? Did you have discussions about the medical loss ratio lower than 85 percent?
A. I really don't recall a number lower. Again, because I think we, Blue Cross of Montana and myself both agreed 2013 was going to take a bump. The only question was how much of a bump.
Q. And then turning then to 2015, you have your assumption is that medical loss ratio will drop to 80 percent, correct?
A. Correct.
Q. And did you have discussions about a range in 2015 for medical loss ratio for Blue Cross/Blue Shield of Montana?
A. Yes, I'm sure at least initial discussions were that it would come down much more gradually from 85, as opposed to 5 percentage points drop in one year, but the thinking was that by 2015, hopefully, costs could be understood and prices would be up to the level they needed to be.

Q. And that -- so if I can, if I -- when we talked in your deposition, am I correct in saying that you have a higher assumption in 2014 in terms of the medical loss ratio because of the uncertainty of health reform; is that right?

A. That's correct.

Q. And then it drops in 2015 because, as you say, perhaps the sickest who are in the market will get into the market -- the sickest or uninsured will get into the market in 2014 and things will perhaps stabilize in 2015 and on going forward; is that right?

A. Yeah, I'm not so sure stabilize -- I guess let me just suggest what stabilized might mean.

Q. Sure.

A. That the premium rates will now already reflect the sicker population which will in all likelihood still be there in 2015, but the premium rates will also have been increased at a level comparable to account for the sicker population. In 2014, it's the unknown as far as the rate is concerned.

Q. So as we're -- I guess let me clarify. As we're moving past 2014, it becomes lesser of an unknown, not that it's known, but it's a lesser unknown on a going forward basis; is that right?

A. That's right. Yeah, what is known is in 2015,

we'll know what happened in 2014.
Q. All right. Fair enough.
And am I also correct that for purposes of your valuation, the medical loss ratio is the biggest driver of the value?
A. I believe so, yes.
Q. Okay. And then if I can, turning to Medical Trends. That's the middle box, Mr. Galasso. Are you following with me?
A. Yes.
Q. Excuse me.
A. Oh, I wonder if we -- if I should just clarify that -- I know we understand, but low medical loss ratio means higher valuation. High medical loss ratio means greater financial losses and lower valuation
Q. Right. I appreciate that. So I'll just tell you what I'm trying to do here. I'm going to try to -- we started with your five scenarios, talked about those in a general sense. Then I want to go to the specific exhibits that we're starting now in terms of your assumptions and then back to those scenarios, so we'll be able to get an idea and particularly the Judge on exactly what you're referring to. Is that fair?
A. Yes, thank you.
Q. Okay. I got ahead of myself a little bit. I

would like to go down to the Premium Rate Changes box, Mr. Galasso, down at the bottom. Are you following me there?

A. Yes.

Q. And am I correct that these percentages in the Premium Rate Changes box represent the percentage increase over the previous year's rates?

A. That's correct.

Q. All right. So in 2013 in the individual market, you're assuming there will be a 15.3 percent increase in the rates that were charged in 2012, right?

A. That's correct.

Q. Okay. So do you know -- and I should also clarify that your numbers that you came up with in the premium rate changes box were in discussions with Blue Cross/Blue Shield of Montana; is that right?

A. No.

Q. No?

A. The two -- the way the discussions went with medical loss ratio and medical trends, and once you set medical loss ratio and medical trends, by definition, premium rate changes have to be what they are.

Q. Okay, very good.

So do you know what the premium rates have done historically in the individual market for Blue

Cross/Blue Shield of Montana?
A. No, I do not.
Q. How about historically in the small group market?
A. No.
Q. And historically in the large group market?
A. No.
Q. So you don't know if the premium rates in 2012 in the individual market, for example, were more or less than the 15.3 percent increase in 2013?
A. I do not know.
Q. Okay. And in 2015 -- I'm still in the Premium Rate Changes box, Mr. Galasso -- you're assuming a premium increase over 2014 of 22 and a half percent; is that right?
A. Yes, that's correct.
Q. And is that increase tied to the medical loss ratio assumption of 85 percent in 2014?
A. The 85 and the 80 percent would be involved in determining what percentage increase you would need for 2013, yes.
Q. Right.
And so in your model, the higher the premium rates increase, the higher the value; is that right?
A. I guess I would put it more, the lower the medical loss ratio, the higher the value. And the lower the

medical loss ratio, the higher the premium rates have to be.

Q. Okay. So directly or indirectly.

Or indirectly?

A. Yes, indirectly, right.

Q. Very good.

And then you're assuming -- I want to introduce this extended period because you've discussed that in your base assumption. Your extended period is the year 2018 through the year 2032; is that correct?

A. Correct.

Q. All right. So in this -- in the Premium Rate Changes box in 2018, you're just simply making the assumption that premiums will increase 7.9 percent each year up to 2032; is that right?

A. That's correct.

Q. And as part of that assumption, Mr. Galasso, you're not assuming that rates will go down from the 7.9 percent, right?

A. For the extended period we're talking?

Q. Correct.

A. Correct.

Q. Okay. Then turning, Mr. Galasso, then to Medical Trends, do you know the -- what the medical trend was in the individual market in 2012 for Blue Cross/Blue Shield

of Montana?
A. I don't know as I -- as we speak. I probably looked at it in the historical data that I have, but I can't recall what it was.
Q. Do you think it's -- do you know if it would be similar to what you've assumed in the individual market in 2013, 8 percent?
A. The best I could say is I wouldn't be surprised but I can't say for sure.
Q. So turning to 2014 then, your medical trend assumption is 25 percent, correct?
A. Correct.
Q. Quite a substantial increase for 2013, right?
A. Yes.
Q. And the basis for that increase, if I'm accurately reflecting what you and I previously discussed in your deposition is obviously due to health reform and in particular a guarantee issue; is that right?
A. That's right.
Q. And in your base scenario that we referenced in Exhibit F, you're assuming a medical trend of 25 percent in the individual market, 2014; is that right?
A. That's correct.
Q. And then you're assuming -- you also referenced small group and that assumption is 18 percent in 2014;

is that right?
A. That's correct.
Q. So those numbers in that base scenario come from the numbers in the Medical Trends box, correct, for individual and small group in 2014?
A. These document what I assumed.
Q. Correct.
A. Yes, that's correct.
MR. LASLOVICH: Your Honor, if I may have another document marked.
HEARING EXAMINER LEAPHART: Yes.
MR. LASLOVICH: This will be Exhibit H.
Q. (By Mr. Laslovich) Mr. Galasso, I've handed you what's been marked as Exhibit H. Do you recognize that?
A. Yes, I do.
Q. And what is that?
A. These are the administrative expense assumptions and commissions and the ACA fee assumptions that went into the model.
Q. Okay. And so in that top box, Total Administrative Expense Ratios, those percentages are a percent of the premium; is that right?
A. That's correct.
Q. And before I go further into that box, if you'll go with me to the Commissions that you have in the

middle box. Do you see that?
A. Yes.
Q. And in the individual market, you're assuming for all projection years, so from 2013 through the 2032, you're assuming that the commissions that the agents will receive in the individual market is 4.49 percent; is that correct?
A. I'm trying to think how the model worked in terms of the administrative expenses out in the extended period, assuming for the 5 years, but yes, I believe it's correct for the whole 20-year period.
Q. Okay. And the 4.49 percent in the individual market is one percent less than what is current, on average, than what is currently paid by Blue Cross/Blue Shield of Montana; is that correct?
A. That's correct.
Q. And you're assuming this one percent decrease, aren't you, because of the MLR requirements that will -- or excuse me, the health reform requirements that are going into effect in 2014 and beyond?
A. That's right, primarily the MLR requirements in health reform, yes.
Q. If in your model, if you assumed in the individual market, for example, that rates were lower than 4.49 percent, that would increase the value?

A. All else equal, yes.
Q. And do you know how much it would increase the value?
A. No, I do not.
Q. In your analysis or in your discussions with Blue Cross/Blue Shield of Montana, did you also have -- discuss a range for the commissions in the individual market?
A. There was discussion about grading the commissions over the five-year period, but the ultimate decision was -- that discussions that we had was agreement to just take current commissions minus one percent, because I don't think there was a foundation for the grading and I think there was a foundation -- I believe Blue Cross of Montana felt they were on their way to negotiating commissions with the agents.
Q. And by grading, do you mean that the commission rate would go down--
A. Go down.
Q. --on a going forward basis?
A. Over the five-year period as opposed to all at once.
Q. And when you said the decision was made to go with 4.49 percent, was that your decision?
A. My decision but in consultation with Blue Cross

management. I relied heavily on Blue Cross management for this one because I had no idea of knowing what their relationships are with their agents and what their commissions were, so I was pretty much advised that this was -- these were the negotiated commissions that would be in the contracts going forward.

Q. So when you say you relied heavily on Blue Cross/Blue Shield of Montana, is it their number then, the 4.49 percent?

A. I would probably -- on this one, I would probably characterize it as a Blue Cross number, yes.

Q. And would that be for all of the numbers in the Commissions box that you have listed there in the middle of the page?

A. Yes.

Q. Turning then to the top box, Mr. Galasso, on the Total Administrative Expense Ratios. In the administrative expense -- can you give us an idea of what you're including as administrative expenses?

A. Well, I don't know if this answers your question but all of the administrative expenses that Blue Cross/Blue Shield of Montana has, everything in their financial statements. These were calculated -- I calculated most of the administrative expense in here with the exception of the commissions and, well, the ACA

fees and I think all the ACA fees when we talk about that. They're all included in the top box.

But in addition to the commissions and the ACA fees, there's the ongoing operations of Blue Cross/Blue Shield of Montana. Those expenses I can find in the financial statements and I got the historical financial statements for the most recent six-month period that I had, for six months of 2012 when I prepared the projection. And I used those numbers. And I did have some discussion with management but we agreed to use the current expenses increased by two percentage points a year, excluding fixed expenses, which I don't know if you want to get into that or not.

Q. Okay. So that I understand, let me back up a little bit. Do you know what the total administrative expense ratio for Blue Cross/Blue Shield of Montana in the individual market in 2012 was?

A. I would -- given what I just said, I think it's very close to the 14.8 percent, with the exclusion of about point four percent for fixed expenses. I think it would be just over 14 percent.

Q. Okay. So by exclusion, you mean it would be about point four lower than 14.8 percent so about 14.4 percent; is that right?

A. You know, well -- sorry about this, but we also

have the commissions and the ACA fees that are muddying the waters a little bit up there with the total admin ratio. I would have to do a little bit more thinking about how to take out commissions and the ACA fees.

Q. Well, let me ask it this way. Is it similar to what you have in the individual market. By it, I mean, what the expense ratio was in 2012? Is it not that it was exact but it was close?

A. The ACA fees were actually zero in 2013 so that's not muddying the waters. Commissions were point one percent, so yeah, it would be fair -- I think 2012 is very similar to 2013

Q. Would that also be for small group and large group business?

A. Yes.

Q. And do you know -- you said that you're assuming that administrative expenses are going to be increasing two percent per year; is that right?

A. Right.

Q. And that was based on discussions with Blue Cross/Blue Shield management?

A. That's correct.

Q. And would you say in the Commissions box, you say that's -- those were Blue Cross/Blue Shield of Montana's numbers. Is the two percent Blue Cross/Blue Shield of

Montana's number?
A. No, their original number was three percent, and in discussions, we agreed to use two percent.
Q. And why did it drop from three percent to two percent, if you can recall?
A. I can't really recall the specifics. I do know early on, we were having trouble getting positive valuation numbers.
Q. Okay. So if I understand you then, you were having trouble getting positive valuation numbers so that -- so by that, you're meaning that your valuation numbers were negative; is that right?
A. (Witness indicates yes.)
Q. So do I understand your testimony to be then that in order to get a positive valuation number, certain assumptions were adjusted to get the valuation into the positive range?
A. I think that's a fair assumption. As long, again, with the caveat that the assumptions were reasonable. Like when they would suggest using three, and I would say, well, do you think it needs to be three. Is it possible, feasible, realistic to assume two. And two seemed reasonable to me and seemed reasonable to them, and so I felt comfortable using a two percent assumption as we've been talking throughout this discussion, a

reasonable range.

Q. So why was it important to have a number in the positive range, the value in the positive range?

A. Well, one of the first questions that I was posed when I took this assignment was how can you take a company that has a track -- a four-year track record of losing money and ascribe a positive value to it using a cash flow analysis. And my response was, well, it really depends on discussions with management in terms of can you convince me, as an actuary, the reasonableness of your assumptions that, in fact, things can be turned around. If you're telling me you can't, then I'm telling you, okay, I'll have to project negative numbers.

But that's where I say we had so much discussion back and forth with management is the discussion are there things that they feel are reasonable on a going forward basis where things were going to look better going forward than they looked in the most four years with all negative. And that's where all the discussions centered around.

Q. So if I can, if I understand you correctly then, the premise was we -- obviously, Blue Cross/Blue Shield of Montana has not performed well in terms of underwriting, is that right, historically in recent

years?
A. The four years I had to look at, correct.
Q. And so to the extent that you were going to have a value that was positive, then they needed to make a case to you essentially about certain assumptions that you would include in your modeling, and if you agreed with those assumptions, then you would include them in your modeling and they may result in a positive number; is that right?
A. That's a good way to say that.
Q. So the assumption is a two percent increase in administrative expenses per year. Do you know what, in the four years that you reference, what Blue Cross/Blue Shield of Montana's administrative expenses have been doing?
Let me ask it this way. Have they been decreasing?
A. I can't say -- I don't believe so, but I can't say as I recall specifically.
Q. And again, did you ever assume in your modeling, Mr. Galasso, that administrative expenses would go down?
A. No.
Q. And am I right to say in your modeling, that the lower the administrative expenses are, the higher the value of the company; is that right?
A. All else equal, yes.

Q. Yeah, thank you. I appreciate all else being equal. I'll try to qualify that.

And these rates, or excuse me, the base Scenario 1 that we referenced at the beginning that you have where you're making the assumption about administrative expense ratio, what is that assumption for base Scenario 1 for administrative expenses?

A. The administrative expenses were not built into the model on a percentage agreement basis. It was built in on a dollar PMPM, and I'm probably going to be off, 17 dollars and X cents, but don't hold me to the X cents, but that was the starting assumption. But the admin expenses including commissions, including ACA, excluding paying taxes.

Q. And I guess we should stop before we go further. You just said PMPM. That means per member per month; is that right?

A. Right, yes.

Q. Can you explain to Justice Leaphart what per member per month means?

A. Yes. A PMPM is an industry term that is used quite often for older financial indicators for managed care organizations. Premium is often expressed as PMPM, which is the total aggregate premium dollars received by a managed care organization divided by the members in a

given month. So the per member per month, the amount Blue Cross is collecting per member per month, the premium; paying per member per month the medical costs, paying per member per month administrative expenses.

Q. So I understand you then, the assumption in base Scenario 1 being the first document that we went through is $17 and some cents PMPM for administrative costs; is that right?

A. Correct, increased by the two percent a year.

Q. And -- I'm sorry?

A. That is what gets increased by the two percent per year that we talked about earlier.

Q. Okay. And from where did that number come?

A. That number came from the first six months of the financial statements.

Q. Of 2012?

A. Exactly, right, the first six months of 2012.

Q. So the PMPM for the first six months in 2012 for Blue Cross/Blue Shield of Montana for their administrative costs was $17 and some odd cents?

A. Less two percent approximately, but it was trended two percentage points starting six months in 2012 through 2013.

Q. And then also, Mr. Galasso, the ACA Fees at the bottom on that exhibit, those are included, aren't they,

in your numbers in the top box?
A. Yes, they are.
Q. All right. And the numbers that are included in the ACA Fees box are not your numbers, is that right?
Well, let me qualify that. Let me not qualify, let me correct that. Blue Cross/Blue Shield of Montana supplied you with the numbers for the ACA fees, correct, their estimates for their portion of the ACA fees?
A. They did. Those I reviewed. Those I could independently review. On my commissions, I could review statements from different sources. These were all very, very consistent.
Q. Okay. So this Blue Cross gave you the number -- Blue Cross/Blue Shield of Montana gave you these numbers and you, unlike the commissions, you were able to verify and you think they are consistent with what the industry is doing?
A. Yes, very much so.
Q. All right.
MR. LASLOVICH: And, your Honor, if I can approach again.
HEARING EXAMINER LEAPHART: Yes.
MR. LASLOVICH: This will be I.
Q. (By Mr. Laslovich) Mr. Galasso, I've handed you what's been marked as Exhibit I. Do you recognize that?

A. Yes, I do.
Q. Is that also included in your report?
A. Yes, it is.
Q. All right. So starting at the top box, let me -- these numbers here, you're assuming, as you say at the top there, the Same for All Projection Years. So the numbers don't vary; is that right?
A. That's correct.
Q. And the last rate, and correct me if my understanding is wrong, but the last rate represents the -- or is what occurs when a member terminates coverage with Blue Cross/Blue Shield of Montana?
A. Correct.
Q. So we're assuming in the individual market for all years, that 23 percent of members of Blue Cross/Blue Shield of Montana will not -- will terminate coverage?
A. Annually?
Q. Correct.
A. Correct. And these numbers I had actual historical data for.
Q. Okay. And we have to kind of look at these boxes in tandem, correct, and by that, I mean, you have the Lapse Rate assumptions and then the bottom box is the Lapse Replacement Ratio, correct? And let me -- well, is that right? Am I right, before I go further, and

then I'm going to explain to you my understanding of what that is and you can tell me if I'm wrong.

A. Yes. Fine.

Q. So the top box the Lapse Rate, 23 percent, you're assuming on an annual basis, Blue Cross/Blue Shield of Montana policyholders will terminate coverage; is that right?

A. Annually, correct.

Q. Yes. And then in 2013, turning to the bottom box for the Lapse Replacement Ratio for the individual market, you're assuming that 44.9 percent of the 23 percent that's in the top box will -- that Blue Cross/Blue Shield of Montana will retain -- or not retain but get 44.9 percent of the 23 percent that leave?

A. Replace them as new sales.

Q. Correct, yes. Thank you.

A. Right.

Q. Very simple, right?

So the 44 -- I just want to be clear, that the 44.9 percent is the percent -- it's 44.9 percent of the 23 percent in the individual market, for example, in 2013?

A. Yeah, I understand it's confusing. It works nice in the model. It's confusing in discussion.

It would be easier if I said they lost a thousand

people and wrote eight hundred new members, would be easy to understand. But as far as modeling it, this works out much nicer when you're trying to look at potential growths or decline on book of business is to think of the lapse -- the lapses are the lapses, but the new sales as a percentage of the lapses is I think a convenient way of looking at what the business is growing and shrinking, a hundred percent growing, less than a hundred percent shrinking.

Q. Mr. Galasso, you forget that I'm probably one of the slower ones in this room, so forgive me.

Let's perhaps maybe do an easier example. So the 23 percent lapse rate that you have in 2015--

A. That's right.

Q. --the assumption is that all of that is going to be made up in new sales?

A. Exactly. That's the assumption. I should have directed you to that. That's the easiest way to understand.

Q. I should have started there. And that's what you're assuming, Mr. Galasso, 2015, '16, '17 and beyond, that they'll lose 23 percent, but they'll get that back in new sales, correct?

A. Well, beyond 2017. 2017 is 75 percent.

Q. Oh, yes. Thank you for that. We'll get to that.

Yes, I appreciate that.

And these numbers, were they also -- but the numbers for both the new business, the lapse replacement ratio and lapse rates for those numbers determined in consultation with Blue Cross/Blue Shield of Montana management?

A. 2014 through '17, yes. 2013 was my kind of complicated way of addressing the prior contract issue.

Q. So how about turning to the top box, the Lapse Rates, were those numbers developed in consultation with Blue Cross/Blue Shield of Montana?

A. Those, I would say were my numbers based on historical experience rounded to what you're looking at here.

Q. Okay. So am I fair to assume that historically, the lapse rate for Blue Cross/Blue Shield of Montana in the individual market has been 23 percent?

A. Yes.

Q. Okay. And the same for the other markets that you have listed there?

A. With the only possible exception, students was a little funny because I think -- the students was a little funny because student had very, very high loss ratios and was requiring large rate increases and a restructuring of the program. There I did consult with

Blue Cross management in terms of what their expectations were in terms of the student program given its adverse experience.

And that's reflected in the 30 percent lapse rate here for students, and in conjunction, as you suggested earlier, the zero percent replacement rate on the bottom of the chart.

Q. Very good.

So this -- so these together, you have an assumption in your base Scenario 1, of the lapse rate in 2014, correct?

A. I'm sorry, would you repeat that.

Q. I'm sorry. You have an assumption in your base Scenario 1 of the lapse replacement ratio in 2014, correct?

A. Correct.

Q. And then you also have an assumption in the extended period of the lapse replacement ratio; is that correct?

A. Correct.

Q. And your assumption for both is 75 percent, right? I'm sorry, if I'm talking 2014.

A. 2014 is 75 percent.

Q. Correct.

And then 75 percent in the extended period, correct?

A. For all the lines of business.
Q. Right.
A. Correct. The 75 is the 2014. That's just individual and small group as opposed to the other segments.
Q. Right.
And you already referenced this, but turning to the Lapse Replacement Ratio box, in the individual market, the 44.9 percent, you in large part came up with that number; is that right?
A. Yes, that's right.
Q. And the reason you came up with that number is due to the provider contracts that we discussed in Scenario 5?
A. Correct.
Q. So the assumption is then that if an acquirer would get less of a discount in those provider contracts, then they would have to charge more premiums; is that right?
A. Correct.
Q. And for every percentage increase in the premiums, your assumption in your modeling, isn't it, that point -- there would be a point seven five percent decrease in business; is that right?
A. That's correct.

Q. And what does that mean?
A. It means at inception, there's going to be fewer members in the individual, small group, and large group market for the acquirer. I think maybe -- I think the number was about 16 percent. I would have to go back and check the report.
It's in the report--
Q. Okay.
A. --what the reduction in membership assumption is.
Q. Okay. And turning then to the Lapse Replacement Ratio in 2014 in the individual and small group markets, you have 75 percent; is that right?
A. That's correct.
Q. And did I understand you earlier that that 75 percent number came from Blue Cross/Blue Shield of Montana management?
A. In large part discussions with management and discussions with the -- that was in conjunction with discussion with loss ratios and trends. Those three were considered in conjunction with one another.
Q. And the 75 percent, the reason -- the basis for the 75 percent number is the assumption that there's going to be an increase in competition in 2014 in the individual and small group markets; is that right?
A. Increase in competition and perhaps some loss of

enrollment with the rate increases, looking at the trend and the rate increases that are assumed to be going.

Q. And so this assumption that you have -- this is the assumption that you have -- I'm sorry -- in your base Scenario 1 in the individual, small group markets of 75 percent, right?

A. Correct.

Q. And does that have an effect obviously on your ultimate value conclusion for the book of business?

A. Yes, it does.

Q. And how much of an effect does it have?

A. That's very difficult because, again, we didn't look at the 75 percent in a vacuum. The 75 percent is in conjunction with the assumed medical loss ratio and the assumed medical trends and consequent premium rate increases, so those were kind of all -- we can't pick and choose in terms of those and say let's change this one and hold them the same. It just doesn't make sense. So that's a very difficult question to answer.

Q. And I appreciate that. And so let me ask you this then, if it were a hundred percent, if the lapse replacement ratio were a hundred percent, would that increase the value?

A. It would, again, assuming you could still keep the same medical loss ratio and the same medical trends, if

you held those at the same level, but I think that would be unrealistic.

Q. Okay. And I appreciate that.

So let's be unrealistic for a second and assume that those are constant, and it goes from 75 percent to 100 percent. Can you quantify the impact--

A. I couldn't.

Q. --on the value that would have?

A. I could not do that without running it through the model.

Q. Okay. But it would increase, would it not?

A. Yes, it would.

Q. And then you also reference, Mr. Galasso, the extended period when it came to the -- when it comes to the lapse replacement ratio, right?

A. Correct.

Q. And the assumption in your base Scenario 1 is 75 percent for the extended period for lapse replacement ratio, right?

A. For all markets, correct.

Q. Correct.

And so is this the exception we discussed earlier, that typically in your assumptions, you're taking the numbers in 2017 and you're just using those numbers on a going forward basis through -- in the extended period,

right, besides--
A. Well, in these scenarios that I've used here?
Q. Correct.
A. Yes.
Q. So this one, there was -- you're assuming in 2017 in all the markets a hundred percent lapse replacement ratio, right?
A. Correct.
Q. And then in 2018 and beyond, it's a 75 percent lapse replacement rate -- yeah, lapse replacement ratio; is that right?
A. Correct.
Q. And that was based on your discussions with Blue Cross/Blue Shield of Montana management; is that right?
A. Yes, it was.
Q. And do you agree with that 75 percent assumption?
A. I struggled with -- I ultimately agreed with it, but I struggled with it being as high as 75 percent as I think we discussed during my deposition.
Q. And am I correct to say that you believe that the assumption of 75 percent is perhaps the most aggressive assumption that you've made in your assumptions?
A. Well, I would probably pick medical loss ratio 1 and 75 percent No. 2.
Q. Okay. And to what extent does the impact on the

value have on Blue Cross/Blue Shield of Montana if it's 75 percent versus 100 percent? Does the value increase if it's 75 percent or does it decrease?

A. Versus a hundred percent?

Q. Correct.

A. If you assume a hundred percent, the value would increase. 75 percent, again, in my opinion is a very aggressive, high assumption. The reason we discussed is that the purchaser would be paying Blue Cross of Montana an awful lot of money for business that they're going to be responsible for in 10, 15, 20 years after acquisition. In my experience, acquirers will not normally want to pay for business that they are responsible for that far out. One year term business 15 years hence to me is a very, very aggressive assumption.

Q. Well, nevertheless, in your -- you certainly included it in your report, so while it's very aggressive, you agree with it?

A. Yes, I agree. I agree with it as an aggressive assumption.

Q. Okay. And then we also -- the final item we have not discussed, Mr. Galasso, on this exhibit is the premium taxes. And that's in the top box, right? Exhibit I is what I'm looking at.

A. Oh, yes. Yes. I'm sorry. Yes.

Q. Blue Cross/Blue Shield of Montana doesn't pay premium taxes currently, does it?
A. They pay something in lieu of premium taxes.
Q. And that something in lieu of premium taxes is the percentage that they would pay to the Montana Comprehensive Health Association; is that right?
A. Correct.
Q. And do you know what that -- that percentage is approximately 1.1 percent; is that right?
A. Correct.
Q. So the assumption of 2.75 percent is higher than what Blue Cross/Blue Shield of Montana has paid historically; is that right?
A. That is correct.
Q. The assumption of 2.75 -- if -- the assumption of 2.75 percent versus the payment of the MCHA percentage of 1.1 percent lowers your value, right?
A. Yes, it does.
Q. Right. So if the -- if the acquirer did not have to pay premium taxes, then the value would increase, correct?
A. You mean if I were doing an evaluation for an acq -- if I were doing an evaluation for an acquirer and I knew they weren't paying premium taxes and everything else was the same, the valuation would increase.

Q. Right. So let me ask it this way. If your assumption was 1.1 percent instead of 2.75 percent, everything else being equal, the value would increase, correct?
A. Yes, it would.
Q. And can you quantify that?
A. Not without going back and doing some number work, no.
Q. So a one percent change -- let's just assume it's a one percent change. You couldn't quantify the impact that that would have on the ultimate value, everything else being equal?
A. I would be very uncomfortable to try to come up with a number sitting here.
Q. Do you remember telling me in your deposition that you felt like a one percent change in the premium taxes would result in a $24 million increase in the value?
A. I remember our discussing it. I remember my trying to qualify it as much as I could; that I wouldn't be comfortable without going back and actually putting it in the model, but yes, I do recall our looking at numbers of that magnitude.
Q. So, yeah, you're just -- and I appreciate that. You were qualifying in your deposition. A lot of it was based on conjecture to use, I think, one of your words.

But just generally, a one percent change would result in a $24 million increase or decrease depending on what that change in the premium taxes would be, right, everything else being equal you're guessing?

A. If I had to guess, which I continue to be reluctant to do, but yes, if I had to guess.

Q. Right.

Okay. Mr. Galasso, let's return to Exhibit F, I believe. Is that the first one I gave you?

A. Yes.

Q. So as we discussed, your assumption in your base scenario for the discount rates respectively for existing business and new business are 8 percent and 13 percent; is that right?

A. Correct.

Q. And the discount rate in a simplistic way represents the concept, doesn't it, that money in the future is worth less than money currently, right?

A. And the risk that money will be there in the future.

Q. Okay. Well, why don't we do it this way. Define, will you, for the Judge what you define the discount rate as.

A. I guess the simple definition I would use is an expected rate of return based on a given business that

an acquirer might look for considering risk and expected cash flows.

Q. Okay. So you've considered a range as you did with the others with the discount rate; is that right?

A. Yes, I did.

Q. And was the lowest part of your range for existing business 7 percent?

A. Yes.

Q. And was the lowest part of your range for new business 12 percent?

A. Yes.

Q. Do you remember discussing with Blue Cross/Blue Shield of Montana perhaps a lower number for discount rate for new business?

A. Early on, we may have discussed it, not in conjunction with the 75 percent continuation of it for an extended period of new business.

Q. So you may have -- so that I understand, you may have had a discussion but it was not in conjunction with the 75 percent--

A. Correct.

Q. --number?

It was just separate?

A. It was when initially we were assuming a 50 percent continuation of new business in the extended

period. And there was a consideration early on of the lower new business discount rate.

Q. So if you had assumed -- let me ask this then. If you had assumed the lapse replacement ratio of 50 percent in the extended period, then the discount rate for new business would have been lower?

A. No, I wouldn't say -- it wouldn't have been lower. I said we had discussions early on in the process of a 50 percent lapse replacement rate and discussions of a range of discount rates from the lower, from 10 to 15 percent, as I said earlier.

Q. Thank you.

All right. So in the discount rate, in your base scenario, everything else being equal, discount rate in existing business of 8 percent and the new business 13 percent, your total appraisal is a little over $24 million; is that right?

A. Correct.

Q. And then if you assume everything else being equal and you lower the discount rates by one percent, so we're at 7 percent for existing business and 12 percent for new business, that results in a total appraisal of $41.5 million, correct?

A. 41.6 rounded, but yes, correct.

Q. I appreciate that. All right.

So that's a difference of approximately seventeen and a half million dollars; is that right?
A. Yes.
Q. So if it were -- if the discount rate were to go even further, if it were 6 percent, for example, for existing business and 11 percent for new business, would it be another increase of seventeen and a half million dollars, everything else being equal?
A. I'm not sure. I wouldn't be surprised but I'm back to a little bit of conjecture. I would have to run it through the model to see. I'm not sure exactly how that would come out, a lot of moving parts.
Q. Do you have a guess?
A. If I had to guess, I mean your number would probably be as good a guess as I could make.
Q. The seventeen and a half million dollars?
A. Yes.
Q. And then returning then to Scenario 3, Mr. Galasso, if we increase the discount rates, 9 percent for existing business and 14 percent for new business, that results in a total appraisal value of $8.7 million; is that right?
A. Correct.
Q. So that's a decrease of approximately -- I should have done the math prior to asking the question, but

under 16 million dollars, correct?
A. Just under, correct.
Q. And if you continue to, as similar to what I asked going down, if we went to 10 percent discount rate and 15 percent as a discount rate for new business, would we keep going down in those increments?
A. I really don't think it's quite that linear, so I'm sure it wouldn't be those numbers but I don't have a better number offhand.
Q. So you think -- would it be less?
A. I don't know. I really don't know.
Q. All right. Well, let me ask this then, if it were, the value in Scenario 3 is $8.7 million, everything considered equal, discount rates are at 9 and 14 percent respectively, and if you raise those discount rates, everything else being equal, would we be in negative value?
A. Very quickly, yes.
Q. Is that fair to say that at the very least, we would have a negative value?
A. Yeah, if it went to 10, 15, yeah, almost certain, it would be a negative value.
Q. Then in base Scenario 1, Mr. Galasso, we've discussed the lapsed replacement ratios in 2014 and the extended period of 75 percent, correct?

A. Correct.
Q. And when I asked you if you could quantify a change in those percentages what the impact would be on value, that was too much conjecture for you, correct?
A. Yes, I couldn't even -- yeah.
Q. So turning then to the next assumption that you have in Scenario 1, below individual and small group medical loss ratios, am I correct that your assumption is, by low, you mean the 83 to 85 percent in the individual market in 2013 and 2014 respectively?
A. And 2015 is also pretty low.
Q. Yeah, 2015 is 80 percent, right?
A. Yeah.
Q. So are you -- by low individual and small group medical loss ratios, you're accounting for each of those medical loss ratios in 2013, '14 and '15; is that right?
A. Correct.
Q. Okay. And that's in the individual market. And then also, you're accounting for the same in the small group market of 2013, '14 and '15, correct?
A. Correct.
Q. And does it go -- are you going beyond?
A. To '17.
Q. Oh, okay. I'm sorry.
A. I guess it would actually extend beyond that

throughout the whole projection period.
Q. Okay. So that I understand then, your assumptions then in base Scenario 1 include all of your assumptions that you had in the individual and small group markets in Exhibit G?
A. That's correct.
Q. All right. So if you -- turning to then the medical loss ratio assumption in your base scenario with those assumptions remaining what they are in your Exhibit G, the total appraisal value is just over $24 million, correct?
A. Correct.
Q. And then turning to Scenario 4, you have -- you have all of the other assumptions in base Scenario 1 except you've increased the medical loss ratio assumptions by one percentage point; is that right?
A. Correct.
Q. And by just that one increase, that almost wiped out the value, correct? We're at $105,000.
A. Correct.
Q. And if you were to increase that another percentage point, are we in the linear line of thought that it would continue to decrease the value by $24 million?
A. It's probably not linear, but it's probably not

crazy to think of it in those terms.
Q. It would be pretty close?
A. The best I'll say is probably.
Q. You actuaries can be as bad as lawyers sometimes. I'm just kidding. I understand.
So if we were to go the opposite direction, Mr. Galasso, then you've accounted for plus one percentage point in the medical loss ratio, and that decreases the value almost $24 million. If we drop the medical loss ratio assumption from -- by one percentage point, would it correspondingly increase to approximately $24 million?
A. Probably in that order of magnitude.
Q. And then we covered the one assumption, the reduction of the commissions by one point, that's -- that reduction by one point, is that from 5.49 percent to 4.49 percent in the individual market or are you going even lower than -- are you going one point -- let me ask you this way, is it one point lower than the 4.49 percent or is it the 4.49 percent in the individual market?
A. If we can look at Exhibit--
Q. Certainly.
A. --Exhibit H.
The 4.49 percent assumed in actually all scenarios

in all years. The historical number was 5.49 percent. The current number is 5, so one percentage point from the current to 4.49 for the projection then from 2013 forward. Is that--

Q. So it's -- I guess let me ask this way. Is it the 4.49 percent number for the individual market?

A. The assumption in the projection?

Q. Yes.

A. Yes, 4.49 percent.

Q. And the reason I'm confused is it says commission reduced by one point?

A. To get to 4.49. It's currently 5.49. I was asked to reduce it by one.

Q. Right. Very good.

We also discussed at the beginning, Mr. Galasso, the assumption of administrative expenses that you have included in base Scenario 1; is that right?

A. Yes.

Q. And you're assuming a two percent increase of, approximate, on top of the 17 point XX per member per month for administrative costs, right?

A. $17?

Q. I'm sorry, yes, 17. I apologize, yes, $17.

A. Yes.

Q. That's why I was -- 17 and some change, correct?

A. Correct.
Q. So in your assumption going forward is those were increased two percent per year, right?
A. Correct.
Q. And if you -- as we discussed in your deposition, if your assumption changed by one percent, what impact would that have on the value? So, for example, if it were less than -- if you dropped it a percent, then how much would the value increase?
A. You mean like a one percent increase instead of a two percent increase?
Q. Yes, if you -- yes, right.
A. I don't know. That would be a tough one.
Q. Do you remember in your deposition where you told me that a one percent decrease in the expense factor would increase the value of the company $24 million?
A. I think we talked about one percent reduction in the 17 -- one percent reduction out of one percent change in the increase.
Q. Oh, I'm sorry.
A. Okay.
Q. So a total one percent reduction, what impact does that have on the ultimate number?
A. Again, in my deposition, I said I assumed that it would probably be comparable to a one percent change in

the medical loss ratio.
Q. And that is--
A. And that was about the -- that's where we were coming around, as much as I hate to say it, something in the neighborhood of $24 million presumably.
Q. All right. And that is in both directions, correct?
A. Yes.
Q. If we're increasing by a percent or decreasing a percent, approximately it's a $24 million hit, as the case may be?
A. My guess, yeah, but I'm not certain, correct.
Q. And by hit, I mean the change in the value?
A. Change, correct.
Q. And then Mr. Galasso, your medical trend assumptions, those are the assumptions that you have in 2014 of 25 percent in the individual market and 18 percent in the small group; is that right?
A. Correct.
Q. And can you -- are you able to quantify if there's a one percent change in the medical trend in those two markets, what that impact has on the value?
A. And again, we're assuming everything else equal?
Q. Yes, sir.
A. I can only give you directionally. I couldn't

give you absolute dollars.
Q. Okay. So and directionally, do you mean increase or decrease?
A. Yes.
Q. So if the -- so let's say if there's a percentage decrease in the assumption?
A. The value would go down.
Q. Okay. And then conversely, if there's a percentage increase, the value would--
A. Would go up.
Q. --would go up?
And then also, Mr. Galasso--
MR. LASLOVICH: And I see, your Honor, that we're getting close to five, and I think I'll be done by five.
HEARING EXAMINER LEAPHART: Okay.
MR. LASLOVICH: I see you glaring at me, get done before five.
Q. (By Mr. Laslovich) Did you exchange -- you exchanged at least one draft with Blue Cross/Blue Shield of Montana; is that right?
A. Correct.
Q. And did your ultimate conclusion, when you averaged the scenarios on the value of the core business of Blue Cross/Blue Shield of Montana, did that change in

those drafts; do you recall?
A. No, not in the -- there was only, as far as I know, there was only one draft report. I hope I'm right there. There might have been two draft reports but I'm thinking of the one draft -- the most recent draft prior to the finalization, there was no change. There was only change in the verbiage.
It was the report that you gave me when I first sat here, that -- the dollars there, I believe the exhibits would have been identical in that report as this report. The only change was in the verbiage and very minor changes.
Q. Okay. So that I understand then, the numbers never changed in the drafts?
A. In the draft that -- the only draft I can think of, right, and the final report, the numbers didn't change.
MR. LASLOVICH: Your Honor, will you just give me one second?
HEARING EXAMINER LEAPHART: Yes.
MR. LASLOVICH: Your Honor, I am done.
Mr. Galasso, always nice seeing you. And I appreciate your Honor's indulgence with my unorganization. Thank you.
HEARING EXAMINER LEAPHART: You bet.

Any cross-examination from the Attorney General's Office?

MS. HUBBARD: None for this witness, your Honor.

HEARING EXAMINER LEAPHART: Recross (sic). Do you want to do it now or would you rather wait until the morning?

MS. WITT: Your Honor, I have very, very short recross (sic).

HEARING EXAMINER LEAPHART: Let's do it then.

REDIRECT EXAMINATION

BY MS. WITT:

Q. Mr. Galasso, I just want to ask you a few questions about the process and the methodology that you used in reaching your opinions in this case and that you use generally in doing an actuarial appraisal. Do you consider a specific buyer or transaction partner in connection with doing the kind of appraisal valuation that you did here?

A. No.

Q. Why not?

A. Well, because I guess I'm not in a position to judge what a potential acquirer -- even if I knew, for example, that HCSC was a party of interest, I have no way of knowing what HCSC -- unless I was asked to do a

due diligence on HCSC, I would have no way of knowing what synergies they may or may not be able to achieve.

Q. When you reached your assumption in conjunction with discussions with the Blue Cross/Blue Shield of Montana people on the commission that you talked with Mr. Laslovich about earlier today, was that assumption based on what Blue Cross/Blue Shield had historically done and could do in the market?

A. The commissions are based on -- I had the actual numbers for 2012, and they were saying they were in the process of renegotiating those with their agents to the point where they would come down one percentage point.

Q. So is it fair to assume that you did not consider, in reaching your assumption on what commission rate to use, the market power or negotiating power of any other entity that was out there in connection with this valuation?

A. That's true.

Q. Is it fair to assume that you did not consider HCSC specifically or any particular attribute of HCSC at all in reaching your valuation?

A. Absolutely.

Q. Now, you talked with Mr. Laslovich about the back and forth that you had with people at Blue Cross/Blue Shield of Montana. Could you describe a little bit how

you went about doing that back and forth.
A. Well, mostly, it was mostly with the phone calls or exchange of emails and primarily with Jim Spencer, the chief actuary, but most of the discussions took place, as it generally does, actuary to actuary. Does this loss ratio, is it achievable and if so, how and why and to what extent.
And that's where that -- and the medical trends were probably -- those were the most -- had the most impact. Medical illustrations in particular, as I said, had the most impact. And it was really just a give and take. Here's your history. How can you assume it's going to go down as much as it is, and just ongoing discussions of that nature. Very difficult to pinpoint exactly the discussion.
Q. Did you rely in part on your own background and experience in the healthcare industry to test, if you will, the assumptions and the information that you were getting from Blue Cross/Blue Shield of Montana?
A. Yes, all the assumptions, I put through my own business mode of what's reasonable and what's not reasonable in the healthcare markets.
Q. And were you able to look at any other materials in connection with any of the assumptions that you reached in order to test the reasonableness of the

assumptions you had been discussing?
A. Well, I mean, I have a fair amount of information on medical loss ratios in the various type market segments that I looked at, and the ACAPs in particular, there's a lot of literature on ACAPs and the impact of the Affordable Care Act. I had independent information I looked at.
Q. Right.
Now, the last set of questions that Mr. Laslovich asked you was about drafts of your report. Were you ever asked during the course of your work for Blue Cross/Blue Shield of Montana to give them any kind of status reports or updates that included particular numbers or assumptions as they existed at that time in your work?
A. There were times where the numbers were exchanged, yes.
Q. And when you talk about a draft of the report, are you referring to a draft that included pretty much the entire -- the entirety of the work that you had been doing on the project at this point?
A. Yes. Yeah, the complete report with all the description of the assumptions, not just an exchange of numbers.
MS. WITT: Okay. Thank you. No further

questions.

HEARING EXAMINER LEAPHART: Thank you, Miss Witt.

Any further cross, Mr. Laslo?

MR. LASLOVICH: Briefly, your Honor.

HEARING EXAMINER LEAPHART: Laslovich. It's getting late in the day.

MR. LASLOVICH: Briefly.

Your Honor, may I have an exhibit marked?

HEARING EXAMINER LEAPHART: You may. It looks frighteningly big.

MR. LASLOVICH: I'll explain.

I'm sorry, Sybil, what was--

THE CLERK: J.

RECROSS EXAMINATION

BY MR. LASLOVICH:

Q. I've handed you what's been marked as Exhibit J, Mr. Galasso. Do you recognize that? It's a -- I'm sorry. J is not on there, but it's Exhibit J. Do you recognize what that document is?

A. It looks like various emails, but no, I do not recognize the document.

Q. So various emails. You say you don't recognize the document, and I appreciate that. But if you'll look with me, Mr. Galasso, under "ActMod Comments," would

those be your comments?
A. I presume so.
Q. So if you look down, Mr. Galasso, at discount rate, do you see that?
A. Yes.
Q. And you -- "ActMod Comments" are 8 percent for existing contracts and 10 percent for new contracts, if any, correct?
A. Yes.
Q. Do you remember emailing Blue Cross/Blue Shield of Montana something like that?
A. As I said, I do remember having an 8 to 10 percent. I don't remember email. I do remember having discussion about 8 and 10 percent.
Q. Okay. And then turning then, Mr. Galasso, to new business, you have in the bottom of the box at least, "ActMod Comments" in the bottom of the box, it says 50 percent methodology sounds reasonable. Do you see that?
A. Yes.
Q. And that's for the lapsed replacement ratio, I presume, correct?
A. Correct.
Q. And that's the ratio we used -- or that was used, it was 75 percent instead of 50 percent?
A. That's correct.

If I could, I think this is what I said earlier when we were talking about 10 percent.

Q. That's right.

Now, also down, Mr. Galasso, to Self-Funded Fees/ Admin. It's three up from the bottom. Do you see that?

A. Yes.

Q. And you have, "In admin expenses; now assuming 3 percent for both fee and expense increases. Does this sound reasonable?" Do you see that?

A. I'm assuming three -- have been assuming three percent--

Q. Yes, sir.

A. --and now two?

Yes.

Q. So, in particular, "In admin expenses; now assuming 3 percent for both fee and expense increases. Does this sound reasonable?" So you're changing from three percent to two percent, correct?

A. Yes, I think that's as I testified earlier also, the three was generating losses and two got it out of the loss position.

Q. Right.

And you said that you don't recognize this document, so do I understand there wasn't a -- when this was given to us, Mr. Galasso, I understood that there was just a

software program where you could communicate back and forth to Blue Cross/Blue Shield, but what you said with Miss Witt under redirect was that you had phone calls and you exchanged emails with Blue Cross/Blue Shield of Montana; is that right?

A. That's right

Q. And that was it?

A. Yes.

Q. And it has here the Blue Cross/Blue Shield of Montana comments. Do you know from whom those comments are?

A. No. I would have to guess.

Q. When you were emailing, you said at the beginning that Mr. Spencer was your primary point of contact?

A. Yes.

Q. If you had to guess, would it be Mr. Spencer?

MS. WITT: Objection, no foundation.

Q. (By Mr. Laslovich) Let me ask this, if I can, your Honor.

Did you email with anybody else at Blue Cross/Blue Shield of Montana?

A. Yes, Mark Burzynski and Chris Manger.

Q. And to whom did you email the most?

A. Jim Spencer.

Q. Okay. So do you have an assumption?

A. I think it varies. When I'm looking at these, some would be Jim, some--
Q. Okay.
A. --would not.
Q. Very good. I appreciate that.
MR. LASLOVICH: Your Honor, if I could have one second.
HEARING EXAMINER LEAPHART: Okay.
MR. LASLOVICH: I have nothing further, your Honor. Thank you.
HEARING EXAMINER LEAPHART: Any further questions?
MS. WITT: Just two.
HEARING EXAMINER LEAPHART: Okay.

FURTHER REDIRECT EXAMINATION

BY MS. WITT:
Q. Mr. Galasso, over what time period did you work on the project that led to your valuation?
A. From August, I think the beginning of August to issuing of the report in November.
Q. And are you like many of us, which means that a lot of the work probably was done in the October and November time period closer to the deadline than at the very beginning of the project?
A. I think I've been pretty busy throughout. I'm not

sure I could put a percentage of where I was busier.
Q. All right. Fair enough.
Take a look at the right-hand column of the document about three-quarters of the way down. And it's in the line on the Medical Loss Ratios & Trends. Do you see where it says, "Major changes are going in for the 9/2012 renewal." Do you see that?
HEARING EXAMINER LEAPHART: I'm sorry, where are you?
MS. WITT: In the line -- it's on the left-hand side, your Honor, that says Medical Loss Ratios & Trends, all the way over on the right.
HEARING EXAMINER LEAPHART: Okay.
THE WITNESS: Yes, I see that.
MS. WITT: It's actually under the blocked part, your Honor. It says, "Major changes are going in for the 9/2012 renewal."
HEARING EXAMINER LEAPHART: Okay.
Q. (By Ms. Witt) There's no date anywhere on this document showing when any of these comments or discussions were taking place, right?
A. Correct.
Q. And that's the only reference to a date suggesting that something was happening in September of 2012, right?

A. I think this is not -- this is I think referring to the student renewal.
Q. Correct, the student renewal change that was going to be made--
A. Right.
Q. --in September of 2012?
A. Yeah, I can't say that I recall the date, but that's what I'm assuming this was in reference to.

MS. WITT: No further questions. Thank you.

MR. LASLOVICH: Thank you, your Honor.

HEARING EXAMINER LEAPHART: Thank you, Mr. Galasso. You may be excused. We will be adjourned until tomorrow morning at 9 a.m.

(Whereupon, the evening recess was taken at 5:10 p.m.)

REPORTER'S CERTIFICATE

I, CHRISTINE D. LIVELY, RPR, DO HEREBY CERTIFY that the foregoing -180- pages of typewritten material constitute a full, true, and correct transcript of my original shorthand notes, as they purport to contain of the proceedings had and taken in the above-entitled matter at the time and place hereinbefore mentioned.

DATED at Butte, Montana this 16th day of March, 2013.

/S/CHRISTINE D. LIVELY, RPR